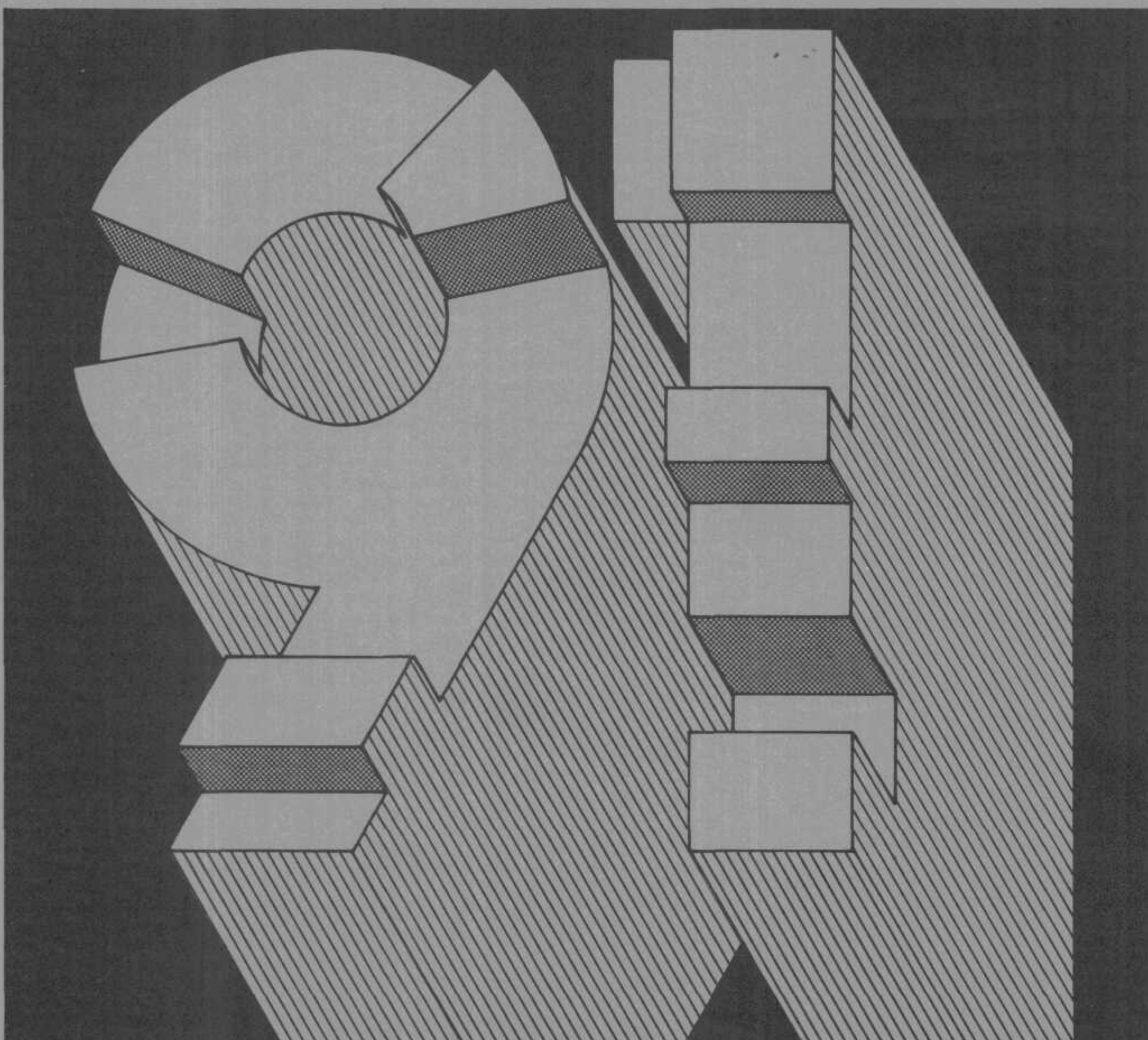
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

MARCH 1990

An Analysis of the President's Budgetary Proposals for Fiscal Year 1991

Prepared at the Request of the
Senate Committee on Appropriations



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S U M M A R Y

March 1990

CBO ANALYSIS OF THE PRESIDENT'S 1991 BUDGET

The Congressional Budget office estimates that the 1991 budget deficit under the President's policy proposals would be $131 billion, almost $70 billion higher than the Administration's estimate. The difference in estimates arises largely because the President's budget makes no allowance for the sizable needs of the Resolution Trust Corporation (RTC) for working capital and also because it uses more optimistic economic assumptions.

In its report, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1991*, CBO recasts the Administration's policy proposals using CBO economic and technical assumptions to assess the likely effect on federal outlays, revenues, and the deficit. CBO's current estimate of the baseline deficit--that is, the deficit that would result from a continuation of current policies--is close to $160 billion for both 1990 and 1991. These figures are more than $20 billion higher than previous CBO estimates, which did not reflect RTC's full needs for working capital. The Administration's recent decision to provide the needed sums through bridge loans from the Treasury's Federal Financing Bank will increase budget outlays and the deficit in 1990 and 1991. In later years, when the RTC sells the assets that it acquires from insolvent thrifts, the proceeds from the sales will reduce the deficit. Consequently, the CBO baseline deficit falls to $124 billion in 1992 and $110 billion in 1995.

The Administration estimates that its proposals will bring the federal budget into surplus by 1993, when it will begin retiring debt held by the public. In contrast, CBO estimates that carrying out the policies proposed in the Administration's budget would still leave a deficit of $79 billion in 1993, although it would nearly balance the budget by 1995 (see table overleaf). Measured against CBO's latest baseline estimates, the President's budget would cut more than $30 billion from the projected 1991 deficit, and almost $100 billion from the 1995 deficit. The largest savings would come from reductions in inflation-adjusted defense spending and from entitlements (mostly Medicare, farm price supports, and federal employee retirement and health benefits).

The budgetary landscape for the next several years is clouded by the costs of the savings and loan crisis, which can wreak havoc with achieving the Balanced Budget Act deficit targets. For some time, CBO has argued that RTC spending should be included in the budget totals but largely excluded from the Balanced Budget Act calculations. The rationale for the exclusion is that such spending does not affect national saving or consumption in the way most federal spending does and that it would also be consistent with the treatment of asset sales under the act.

Questions regarding the budget estimates should be directed to the Budget Analysis Division (202-226-2880), and inquiries about the economic assumptions should be addressed to the Fiscal Analysis Division (226-2750). The Office of Intergovernmental Relations is CBO's Congressional liaison office and can be reached at 226-2600. For additional copies of the report, please call the Publications Office at 226-2809.

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CBO ESTIMATES OF THE ADMINISTRATION'S BUDGETARY PROPOSALS
(By fiscal year, in billions of dollars)

	1991	1992	1993	1994	1995
CBO Baseline Deficit	161	124	132	121	110
Policy Changes					
Revenues[a]	-9	-4	b	-2	-2
National defense	-3	-8	-16	-26	-35
Nondefense discretionary spending	-1	-2	-4	-7	-11
Entitlements and other mandatory spending	-13	-18	-21	-23	-26
Offsetting receipts	-3	-4	-6	-6	-8
Net interest	-1	-4	-7	-11	-17
Total	-31	-41	-54	-74	-99
President's Budget as Estimated by CBO	131	84	79	47	11
President's Budget Estimates	61	24	(20)[c]	(64)[c]	(111)[c]
CBO Reestimates					
Economic	26	54	84	105	117
Techinical	44	5	15	6	5
Total Reestimates	69	60	99	112	122

SOURCE: Congressional Budget Office.

NOTE: The budget figures include Social Security and exclude the Postal Service.

a. Revenue increases are shown with a negative sign because they reduce the deficit.

b. Less than $0.5 billion.

c. Figures in parentheses represent estimated surpluses.

AN ANALYSIS OF THE PRESIDENT'S BUDGETARY PROPOSALS FOR FISCAL YEAR 1991

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in Chapter II and Appendix B are calendar years, and all years in all other chapters and Appendix A are fiscal years.

Unemployment rates throughout the report are calculated on the basis of the civilian labor force.

Details in the text and tables of this report may not add to totals because of rounding.

The source of data concerning President Bush's budget is the Office of Management and Budget. The source of other data, unless otherwise noted, is the Congressional Budget Office.

The Balanced Budget and Emergency Deficit Control Act of 1985 (popularly known as Gramm-Rudman-Hollings) is also referred to in this volume more briefly as the Balanced Budget Act. This act was amended by the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987.

The Omnibus Budget Reconciliation Act of 1989 is referred to more briefly as the Reconciliation Act.

A glossary of economic and budget terms used in this report appears in Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1991-1995* (January 1990).

PREFACE

This analysis of the President's budget for fiscal year 1991 was prepared at the request of the Senate Committee on Appropriations. The report discusses the President's policy proposals in terms of changes from the Congressional Budget Office (CBO) baseline budget projections for 1991 through 1995. It provides estimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods.

This report was prepared by the staffs of the Budget Analysis, Fiscal Analysis, and Tax Analysis Divisions under the supervision of James L. Blum, Frederick C. Ribe, and Rosemary Marcuss, respectively. Paul N. Van de Water was responsible for Chapter I; Douglas Hamilton for Chapter II; Kathleen M. O'Connell and Larry Ozanne for Chapter III; Michael Miller for Chapter IV; Charles E. Seagrave and Robert A. Sunshine for Chapter V; Kathy Ruffing, Mary B. Maginiss, Robert A. Sunshine, and Paul N. Van de Water for Appendix A; and John Peterson for Appendix B. Principal contributors to the revenue and spending estimates are listed in Appendix C.

Paul L. Houts, Francis S. Pierce, and Sherry Snyder edited the report. Nancy H. Brooks provided editorial support during production. The authors wish to thank Cindy Cleveland, Marion Curry, Janice Johnson, Verlinda Lewis, L. Rae Roy, Simone Thomas, and Emma Tuerk for typing the many drafts. Kathryn Quattrone prepared the report for publication.

Robert D. Reischauer
Director

March 1990

CONTENTS

I	SUMMARY AND INTRODUCTION	1
	CBO and Administration Budget Estimates *1* The Administration's Budget Program *6* Issues in Measuring the Deficit *10*	
II	COMPARISON OF ECONOMIC ASSUMPTIONS	17
	Short-Term Outlooks *18* Medium-Term Projections *20* Evaluating Economic Assumptions *26* Implications of Economic Assumptions for Deficits *32*	
III	THE ADMINISTRATION'S REVENUE PROPOSALS	35
	Revenue Proposals *35* CBO Reestimates *59*	
IV	THE ADMINISTRATION'S PROPOSALS FOR DEFENSE AND INTERNATIONAL AFFAIRS	65
	The Defense Budget Compared With the CBO Baseline *66* Major Defense Proposals *69* CBO Reestimates of the Administration's Request for Defense *82* The Administration's Budget Request for International Affairs *84* CBO Reestimates of the Administration's Request for International Affairs *88*	

V THE ADMINISTRATION'S DOMESTIC PROPOSALS 91

Entitlements and Other Mandatory Spending 92
Nondefense Discretionary Spending 94
Offsetting Receipts 98
Net Interest 100
The President's Domestic Proposals by Function 101

250 General Science, Space, and Technology 103
270 Energy 106
300 Natural Resources and the Environment 110
350 Agriculture 113
370 Commerce and Housing Credit 118
400 Transportation 125
450 Community and Regional Development 128
500 Education, Training, Employment, and Social Services 132
550 Health 139
570 Medicare 144
600 Income Security 154
650 Social Security 163
700 Veterans Benefits and Services 166
750 Administration of Justice 171
800 General Government 174
900 Net Interest 177
920 Allowances 180
950 Undistributed Offsetting Receipts 182

APPENDIXES

A Baseline Budget Projections *189*

B Comparison of the CBO and Administration Economic Forecast Records *201*

C Major Contributors to the Revenue and Spending Estimates *213*

TABLES

I-1.	CBO and Administration Estimates of the Deficit Under Administration Policies	4
I-2.	The Administration's Deficit Reduction Program as Estimated by CBO	7
I-3.	CBO Estimates of the Administration's Budget Program	8
I-4.	On- and Off-Budget Totals in CBO's Estimate of the President's Budget	12
I-5.	CBO Baseline and CBO Estimate of the President's Budget Excluding Noninterest Outlays of the Resolution Trust Corporation	14
II-1.	Comparison of CBO, Administration, and *Blue Chip* Short-Run Economic Forecasts	19
II-2.	Comparison of CBO, Administration, and *Blue Chip* Economic Assumptions, Calendar Years 1989-1995	22
II-3.	Growth of Nonfarm Business Productivity	30
II-4.	Effects of CBO Economic Assumptions on Estimates of the Administration's Budget	32
III-1.	Administration and CBO Estimates of Administration Budget Revenues, by Major Source	36
III-2.	CBO Estimates of Revenue Proposals in the Administration's 1991 Budget	37

III-3.	CBO Estimates of the Administration's Proposed Savings and Investment Incentives	38
III-4.	CBO Estimates of the Administration's Proposed Extensions of Expiring Income Tax Provisions	45
III-5.	CBO Estimates of the Administration's Proposed Oil and Gas Industry Incentives	47
III-6.	CBO Estimates of the Administration's Proposed Payroll Tax Increases	49
III-7.	CBO Estimates of the Administration's Proposed Excise Tax and Fee Increases	52
III-8.	CBO Estimates of the Administration's Internal Revenue Service Initiatives	55
III-9.	CBO Estimates of the Administration's Other Revenue Proposals	58
III-10.	CBO Reestimates of Administration Budget Revenues	59
IV-1.	Proposed Major Spending Changes in the President's Budget for Function 050, National Defense	67
IV-2.	Real Changes in National Defense Budget Authority	70
IV-3.	Summary of Active Forces	72
IV-4.	Investment in the Next Generation and Current Generation of Weapons	77

IV-5.	Selected Program Changes for Aircraft and Missile Procurement in the President's Request for Fiscal Year 1991	79
IV-6.	Investment in Strategic and General Purpose Weapons	81
IV-7.	CBO Reestimates of Proposed Spending in the President's Budget	83
IV-8.	Proposed Major Spending Changes in the President's Budget for Function 150, International Affairs	85
IV-9.	CBO Reestimates of Proposed Spending in the President's Budget for Function 150, International Affairs	89
V-1.	CBO Estimates of the President's Proposals for Entitlements and Other Mandatory Spending	93
V-2.	CBO Estimates of the President's Proposals for Nondefense Discretionary Spending	96
V-3.	Nondefense Discretionary Spending, Fiscal Year 1991	97
V-4.	CBO Estimates of the President's Proposals for Offsetting Receipts	99
A-1.	Baseline Budget Projections	190
A-2.	Revisions to CBO Baseline	191
A-3.	CBO and Administration Estimates of RTC Spending	196
A-4.	Projected Uses and Sources of RTC Cash, Fiscal Years 1990-1992	198

B-1.	Comparison of CBO and Administration Two-Year Forecasts of Real GNP Growth	204
B-2.	Comparison of CBO and Administration Two-Year Forecasts of the CPI Inflation Rate	205
B-3.	Comparison of CBO and Administration Two-Year Forecasts of Nominal Short-Term Interest Rates	207
B-4.	Comparison of CBO and Administration Two-Year Forecasts of the Inflation-Adjusted Short-Term Interest Rate	208
B-5.	Ranking of CBO and Administration Two-Year Forecasts, Calendar Years 1978-1988	209
B-6.	Comparison of CBO and Administration Longer-Term Projections of Real GNP Growth	210

FIGURES

I-1.	Federal Deficit Projections	2
II-1.	Comparison of CBO and Administration Economic Assumptions	24
II-2.	CBO, Administration, and the Range of the *Blue Chip* Forecasts for Calendar Years 1990 and 1991	27

BOX

IV-1.	Deferrals and the Panama Supplemental	68

CHAPTER I

SUMMARY AND INTRODUCTION

The Congressional Budget Office (CBO) estimates that the Bush Administration's budget proposals would cut more than $30 billion from the projected 1991 deficit, bringing it down to $131 billion. CBO's deficit estimate is almost $70 billion higher than the Administration's. The difference in estimates arises largely because the Administration's budget makes no allowance for the sizable needs of the Resolution Trust Corporation (RTC) for working capital and uses more optimistic economic assumptions.

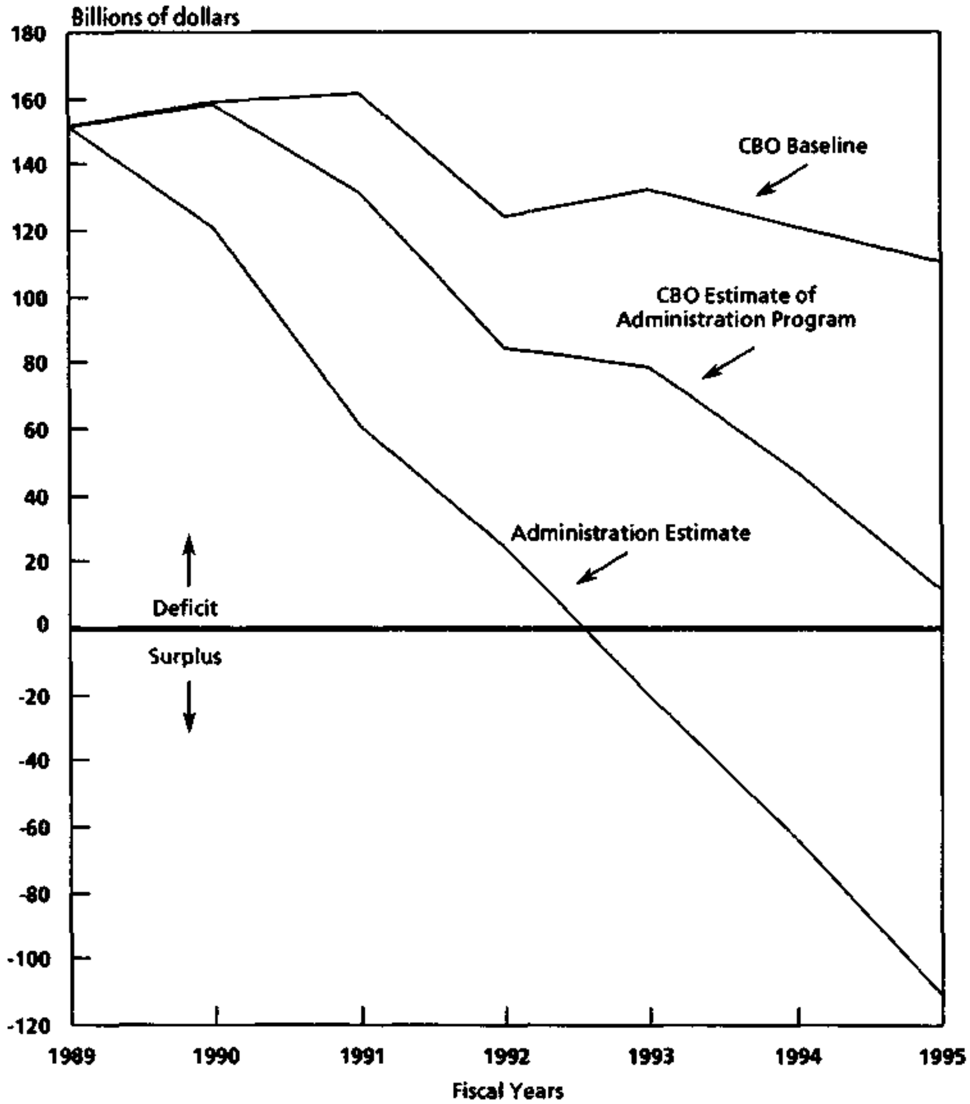
CBO's current estimate of the baseline deficit--that is, the deficit that would result from a continuation of current policies--is close to $160 billion in both 1990 and 1991. These figures are over $20 billion higher than the previous CBO estimates, which did not reflect RTC's full needs for working capital. The baseline deficit falls to $124 billion in 1992 and $110 billion in 1995.

The Administration projects that its proposals will bring the federal budget into surplus by 1993, when it will begin retiring debt held by the public. In contrast, CBO estimates that carrying out the policies proposed in the Administration's budget would still leave a deficit of $79 billion in 1993, although it would nearly balance the budget by 1995. Figure I-1 compares CBO and Administration projections of the federal budget.

CBO AND ADMINISTRATION BUDGET ESTIMATES

CBO analyzes the Administration's fiscal program in terms of changes from CBO's baseline budget projections, which show what would happen if current taxing and spending policies were continued without change. CBO reestimates, or reprices, the Administration's budget using CBO's economic assumptions and technical estimating methods. The differences between the baseline and the CBO estimate of the budget measure the effect of the Administration's proposed policy changes.

Figure I-1.
Federal Deficit Projections



SOURCE: Congressional Budget Office; Office of Management and Budget.

NOTE: The budget figures include Social Security and exclude the Postal Service.

Baseline Budget Projections

CBO's baseline budget projections hew to the rules contained in the Balanced Budget Act. For receipts and entitlement spending, the baseline generally assumes that laws now on the statute books will continue. For defense and nondefense discretionary spending, the projections for 1991 through 1995 are based on the 1990 appropriations, increased only to keep pace with inflation.

The baseline budget projections contained in this volume update those published in CBO's annual report of January 1990 to reflect newly available information. While CBO has substantially increased its estimate of the Resolution Trust Corporation's outlays, other revisions are small. In its annual report, CBO noted that RTC's outlays were constrained because it lacked sufficient funds to deal with the hundreds of insolvent thrift institutions that had been entrusted to it. Since then, the Department of Justice has informed RTC that it is eligible for bridge loans from the the Federal Financing Bank (FFB). CBO now estimates that the RTC will borrow some $24 billion from the FFB in 1990 and another $31 billion or so in 1991. The additional costs of case resolutions financed by this borrowing will count as budget outlays and swell the federal deficit for the next two years. In later years, when the RTC sells the assets that it acquires from insolvent thrifts, the proceeds from the sales will reduce the deficit.

Under CBO's baseline budget projections, the deficit is projected to rise from $152 billion in 1989 to $159 billion in 1990 and $161 billion in 1991. The baseline deficit then drops to an average of $125 billion in 1992 through 1994 and to $110 billion in 1995. In relation to the size of the economy, the baseline deficit is near 3 percent of gross national product (GNP) in 1989, 1990, and 1991, 2 percent of GNP in 1992 and 1993, and 1.5 percent of GNP in 1995. Appendix A presents the baseline budget projections and explains the revisions, particularly the estimates of RTC working capital.

Projections of the Bush Administration's Policies

CBO estimates that the 1991 budget deficit under the Bush Administration's policies would be $131 billion--$69 billion more than the Administration's own estimate of $61 billion. About $44 billion of the

$69 billion in reestimates is attributable to differing technical estimating assumptions, primarily for RTC working capital and other costs of deposit insurance. The remaining $26 billion difference stems from differences in economic assumptions. CBO's deficit estimates exceed the Administration's by $60 billion in 1992, $99 billion in 1993, and $122 billion in 1995--mostly because of different economic assumptions (see Table I-1).

TABLE I-1. CBO AND ADMINISTRATION ESTIMATES OF THE DEFICIT UNDER ADMINISTRATION POLICIES (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
Administration Deficit or Surplus Estimate	121	61	24	(20)[a]	(64)[a]	(111)[a]
CBO Economic Reestimates						
Revenues	1	19	36	55	64	63
Interest	-1	6	17	27	36	44
Other outlays	b	1	1	3	5	9
Subtotal	b	26	54	84	105	117
CBO Technical Reestimates						
Revenues	5	5	3	-4	-12	-17
Deposit insurance	31	29	-6	4	-6	-3
Medicaid and Medicare	-2	2	4	7	10	12
Interest	4	4	6	8	10	11
Asset sales and leases	0	3	b	b	b	b
Other	-1	1	-1	-2	5	1
Subtotal	36	44	5	15	6	5
Total Reestimates	37	69	60	99	112	122
CBO Deficit Estimate	158	131	84	79	47	11

SOURCES: Office of Management and Budget; Congressional Budget Office.

NOTE: The budget figures include Social Security and exclude the Postal Service. Following standard budgetary accounting, the estimates of the Administration budget do not treat payments to the Social Security Integrity and Debt Reduction Fund as budget outlays.

a. Figures in parentheses represent estimated surpluses.

b. Less than $0.5 billion.

Economic Assumptions. The Administration is considerably more optimistic than CBO on the outlook for noninflationary growth, as discussed in Chapter II. Over the 1990-1995 period, the Administration projects average real growth that is 0.7 percent a year higher than CBO's. Despite this stronger growth, the Administration assumes about the same inflation rates as CBO through 1992 and somewhat lower inflation thereafter. The Administration's assumed inflation-adjusted interest rates are also lower than CBO's by an average of more than one percentage point.

Revenues and interest account for almost all of the differences between CBO and the Administration attributable to economic factors. Because of its projected higher growth rates, the Administration has higher taxable incomes than CBO--and therefore larger tax collections--in all years. In addition, the Administration's higher revenues and lower interest rates lead to lower federal borrowing costs. In total, substituting CBO's economic assumptions for the Administration's increases the estimated deficit by $26 billion in 1991, $54 billion in 1992, and $117 billion in 1995.

Technical Estimating Assumptions. CBO's technical reestimates increase the estimated 1991 deficit by $44 billion. Of this amount, $29 billion represents RTC working capital and other deposit insurance requirements. In its budget submission, the Administration deliberately excluded the RTC's working capital needs from its estimates. The reason given was the problematic treatment of these transactions under the Balanced Budget Act, an issue that is considered below. Since the budget was released, however, the RTC has indicated its intention to meet its working capital needs through borrowing from the FFB, and CBO has included an estimate of this borrowing in its figures.

More than $7 billion in technical differences in 1991 result from lower CBO estimates of the effects of various Administration proposals. The Administration estimates that its proposal to exclude 30 percent of gains realized on capital assets will raise $4.9 billion in revenue in 1991; the Joint Committee on Taxation estimate, with which CBO concurs, shows a revenue gain of only $3.2 billion in 1991 and a revenue loss thereafter. CBO also assumes that no additional revenues will result from the Administration's proposed improvements to Internal Revenue Service management, changes that the Adminis-

tration estimates will yield $2.5 billion in 1991. On the outlay side of the budget, CBO estimates that the proposed sale of part of the Southeastern Power Marketing Administration, which the Administration assumes will produce $1.2 billion in offsetting receipts in 1991, cannot be consummated until 1992. Also, leasing a portion of the unassigned radio spectrum is likely to raise only $0.4 billion in 1991, not the $2.3 billion counted on by the Administration.

After 1991, technical estimating differences between CBO and the Administration are smaller, adding an average of $8 billion per year to CBO's deficit estimates. CBO's estimates of Medicaid, Medicare, and interest spending are higher than the Administration's, but CBO's revenue estimates--leaving aside differences stemming from economic assumptions--are generally higher as well. CBO's reestimates of revenues, defense, and domestic spending are explained in more detail in Chapters III, IV, and V.

THE ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the Administration's budget program can be measured. Because the baseline and the CBO estimate of the President's budget employ the same economic and technical estimating assumptions, differences between the two are solely the result of proposed policy changes. CBO estimates that the Administration's budget proposals would reduce the deficit by $31 billion in 1991, substantially more than has been achieved in most recent years. The proposed deficit reduction grows to $41 billion in 1992 and $99 billion in 1995, as shown in Table I-2. Table I-3 shows CBO's estimates of the Administration's budget program by major tax source and spending category.

President Bush proposes little in the way of higher taxes. The Administration's proposals (detailed in Chapter III) would increase revenues by $9 billion in 1991 but only about $2 billion per year in 1992 through 1995. Excluding up to 30 percent of capital gains from taxation would produce a $3 billion spurt of revenues in 1991 but a loss of $3 billion to $4 billion per year thereafter. The budget also proposes to increase revenues by $4 billion per year by extending Social Security coverage to state and local government employees not covered by a retirement plan and by extending Medicare coverage to all state and

local workers. Excise tax proposals--primarily an extension of the telephone tax and an increase in airport and airway taxes--would raise $4 billion in 1991 and $7 billion in 1995. These revenue increases are largely offset, however, by the cost of the capital gains exclusion, family savings accounts, extension of the research and experimentation credit and allocation rules, and oil and gas preferences. Under the Administration's proposals, revenues would represent 19.8 percent of GNP in 1991 but would grow less rapidly than the economy thereafter.

For the first time since the end of the Vietnam War, the President's budget proposes a sustained reduction in real defense spending. Despite nominal annual increases, the budget calls for a 2 percent decline each year in inflation-adjusted dollars. Thus, by 1995, defense

TABLE I-2. THE ADMINISTRATION'S DEFICIT REDUCTION PROGRAM AS ESTIMATED BY CBO
(By fiscal year, in billions of dollars)

	1991	1992	1993	1994	1995
CBO Baseline Deficit	161	124	132	121	110
Policy Changes					
Revenues[a]	-9	-4	b	-2	-2
National defense	-3	-8	-16	-26	-35
Nondefense discretionary spending	-1	-2	-4	-7	-11
Entitlements and other mandatory spending	-13	-18	-21	-23	-26
Offsetting receipts	-3	-4	-6	-6	-8
Net interest	-1	-4	-7	-11	-17
Total	-31	-41	-54	-74	-99
President's Budget as Estimated by CBO	131	84	79	47	11

SOURCE: Congressional Budget Office.

NOTE: The budget figures include Social Security and exclude the Postal Service.

a. Revenue increases are shown with a negative sign because they reduce the deficit.

b. Less than $0.5 billion.

TABLE I-3. CBO ESTIMATES OF THE ADMINISTRATION'S BUDGET PROGRAM (By fiscal year)

	1990	1991	1992	1993	1994	1995
	In Billions of Dollars					
Revenues[a]						
Individual income	491	530	557	593	632	673
Corporate income	102	110	114	118	123	130
Social insurance	388	416	442	467	499	530
Other	87	91	95	99	103	107
Total	1,068	1,146	1,208	1,276	1,356	1,440
Outlays						
National defense	296	304	309	312	319	320
Nondefense discretionary spending	207	219	228	233	239	243
Entitlements and other mandatory spending	604	635	636	690	728	778
Net interest	179	183	186	191	193	191
Offsetting receipts	-60	-63	-68	-72	-75	-81
Total	1,226	1,277	1,292	1,355	1,404	1,451
Deficit	158	131	84	79	47	11
	As Percentages of GNP					
Revenues						
Individual income	9.0	9.1	9.0	9.0	9.0	9.0
Corporate income	1.9	1.9	1.9	1.8	1.8	1.7
Social insurance	7.1	7.2	7.1	7.1	7.1	7.1
Other	1.6	1.6	1.5	1.5	1.5	1.4
Total	19.6	19.8	19.5	19.4	19.3	19.3
Outlays						
National defense	5.4	5.2	5.0	4.7	4.6	4.3
Nondefense discretionary spending	3.8	3.8	3.7	3.5	3.4	3.3
Entitlements and other mandatory spending	11.1	11.0	10.3	10.5	10.4	10.4
Net interest	3.3	3.2	3.0	2.9	2.8	2.6
Offsetting receipts	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Total	22.5	22.0	20.9	20.6	20.0	19.4
Deficit	2.9	2.3	1.4	1.2	0.7	0.1

SOURCE: Congressional Budget Office.

NOTE: The projections include Social Security, which is off-budget but is counted for purposes of the Balanced Budget Act targets. For comparability with the targets, the projections exclude the Postal Service, which is also off-budget.

budget authority would decline by about 11 percent in real terms. Compared with the baseline, the outlay savings would be small at first--only $3 billion in 1991--but would grow to $35 billion by 1995. By 1994 and 1995, cuts in defense spending represent fully one-third of the Administration's proposed deficit reduction. The Administration's budget proposals would cause defense outlays to fall from 5.4 percent of GNP in 1990 to 4.3 percent of GNP in 1995, which would be (except for 1948) the lowest level since before World War II. Chapter IV describes the Administration's defense and international affairs budget proposals in more detail.

In the aggregate, nondefense discretionary spending is not a major target of the Administration's deficit reduction proposals. Some programs would be cut deeply, however, while a few would be increased substantially. Increases are slated for the space station and other space-related activities, the National Science Foundation, the superconducting super collider, aviation facilities and equipment, and Head Start. The budget also provides for renewing long-term subsidized housing contracts that are about to expire. Significant cuts would be made in the direct loan programs of the Farmers Home and Rural Electrification administrations, construction grants for sewage treatment plants, mass transit subsidies, community and regional development, and low-income energy assistance. Now at 3.8 percent of GNP, its lowest level in more than 30 years, nondefense discretionary spending would fall to 3.3 percent of GNP in 1995 under the Administration's proposals.

In 1991, the largest amount of deficit reduction--$13 billion--is to be achieved from entitlements and other mandatory spending. Proposed cuts in Medicare payments to doctors and hospitals, including the extension of cost-saving provisions that expire in 1990, total $5 billion. Reducing cost-of-living adjustments in the Civil Service and Military Retirement systems and other changes in federal employee retirement would save $3 billion. Yet-to-be-specified reforms in farm price supports and federal employee health benefits would reduce outlays by almost $2 billion each. The only major increase in entitlement spending recommended by the Administration is a refundable tax credit for low-income working families with children. Together with making the existing child care credit refundable, this proposal would cost $2 billion by 1995. In total, entitlement spending in 1995 would be cut by $26 billion. As a share of GNP, however, entitlement spending

would remain near recent levels (excluding extraordinary deposit insurance outlays).

The budget proposals would increase offsetting receipts by $3 billion in 1991 and more in later years. One-time savings would arise from selling the Alaska and Southeastern power marketing administrations and other unspecified assets, leasing rights for oil and gas production in the naval petroleum reserves and Arctic National Wildlife Refuge, and charging for the use of certain unassigned radio frequencies. Continuing reductions would result from maintaining premiums for Part B of Medicare at a level sufficient to pay for 25 percent of the program's costs and from extending customs user fees that are about to expire. The Administration also proposes to charge government-sponsored enterprises a fee for issuing securities.

Under the President's proposals, total spending would fall below 20 percent of GNP in 1995, a level last seen in the early 1970s. The composition of spending, however, would be substantially different. In 1971, for example, defense and nondefense discretionary spending together accounted for about 60 percent of the budget. In 1995, under the President's proposals, they would represent less than 40 percent of the total.

ISSUES IN MEASURING THE DEFICIT

Recent discussions of budgetary policy have become mired in confusion over what is the real deficit. For the most part, this confusion has arisen over accounting for the surpluses of the Social Security trust funds and the costs of the savings and loan rescue. The President's budget contains a proposal to change the way Social Security surpluses are treated under the Balanced Budget Act but does not deal with the thrift insurance issue. In both cases, CBO argues, the proper deficit to target is one that measures the extent to which the federal government draws on private saving to finance government consumption.

Social Security

The current deficit targets are $64 billion for 1991, $28 billion for 1992, and zero for 1993. The Balanced Budget Act includes Social Security in these calculations and thereby makes Social Security subject to the same fiscal discipline as the rest of the budget. From an economic perspective, this treatment of Social Security makes sense.

The chief importance of the federal deficit is accounting for the government's use of private saving. When the deficit increases (other than for additional spending on physical or human investments), the government is diverting more private saving to public consumption. When the deficit is cut, the government is using less saving. The annual balance in the Social Security programs affects national saving in exactly the same way as the balance in any other government accounts.

It is also difficult to make the case that the Social Security surplus has been hiding the deficit in the remainder of the budget. The Balanced Budget Act took Social Security off-budget precisely to highlight its importance to the overall deficit. Both CBO and the Administration have been showing figures on the Social Security surplus and the deficit in the rest of the budget since early 1986, as have the budget resolutions adopted by the Congress (see Table I-4).

Despite these arguments, recent months have produced a plethora of proposals to exclude Social Security from the Balanced Budget Act process. The Administration's budget contains a two-part variation on this theme. First, the Administration would extend the requirement of a balanced budget indefinitely, rather than allow it to expire after 1993. Second, the Administration proposes a Social Security Integrity and Debt Retirement Fund, which would record a growing portion of the anticipated Social Security surpluses as a budget outlay.

The Administration's proposed fund, however, is not really a fund at all. It is merely an accounting change that would classify reduction of debt as an outlay rather than simply as a use of the budget surplus. Under standard accounting practices, the federal deficit is a good measure of the amount the government must borrow from the public. Similarly, if the government ran a surplus as normally measured, the surplus would approximate the amount of publicly held debt that

would be retired. By treating the retirement of debt as an outlay, the Administration's plan for balancing the budget in fact involves running a budget surplus under traditional accounting.

In any event, by CBO's estimates, the Administration's proposals would not meet the current Balanced Budget Act targets and would not balance the budget. Under those circumstances, the publicly held debt would continue to increase. Because the Administration's proposed accounting change would have no substantive effect and would exaggerate the reported deficit, the budget estimates in this report follow standard budgetary accounting rules.

TABLE I-4. ON- AND OFF-BUDGET TOTALS IN CBO'S ESTIMATE OF THE PRESIDENT'S BUDGET (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
On-Budget (Excludes Social Security and Postal Service)						
Revenues	780	835	875	923	978	1037
Outlays	1,003	1,042	1,047	1,100	1,140	1,178
Deficit	223	207	172	177	162	142
Off-Budget[a] (Social Security)						
Revenues	288	311	333	353	379	403
Outlays	223	235	245	255	264	273
Surplus	65	76	88	98	114	130
Total						
Revenues	1,068	1,146	1,208	1,276	1,356	1,440
Outlays	1,226	1,277	1,292	1,355	1,404	1,451
Deficit	158	131	84	79	47	11

SOURCE: Congressional Budget Office.

a. For comparability with the Balanced Budget Act targets, the estimates exclude the Postal Service, which is also off-budget.

Thrift Insurance

The budgetary landscape for the next several years is clouded by the costs of the savings and loan crisis. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) authorized $50 billion for the Resolution Trust Corporation to close or sell hundreds of insolvent institutions. This amount was intended to pay for deposit insurance losses that would never be recovered, although it is almost certainly insufficient for that purpose. CBO estimates that, by 1992, RTC will need at least $25 billion to $30 billion more to cover net losses.

In the course of liquidating insolvent institutions, however, RTC will need to purchase assets well in excess of the amount of their net losses. Eventually, the acquired assets will be sold, and part of their purchase price will be recovered. In the meantime, however, RTC will need substantial amounts of working capital--$40 billion to $100 billion by the Administration's estimate. RTC has recently indicated that it will borrow the needed sums from the Treasury's Federal Financing Bank.

The costs of the savings and loan crisis can wreak havoc with achieving the Balanced Budget Act targets. The Congress effectively excluded the $50 billion down payment authorized in FIRREA from the Balanced Budget Act process: $20 billion was appropriated for fiscal year 1989 when it was too late to affect the automatic reduction procedure, and $30 billion is to be borrowed by an off-budget entity. Likewise, borrowing from the FFB to meet working capital needs would no longer affect the Balanced Budget Act process for 1990. But it would put the 1991 deficit target of $64 billion even farther out of reach. In 1992 and 1993, however, proceeds from asset sales could make it easier to reach the targets.

For some time, CBO has argued that RTC spending should be included in the budget totals but largely excluded from the Balanced Budget Act calculations. The rationale for the exclusion is that such spending does not affect national saving in the way that most federal spending does. Unlike most recurrent federal expenditures, RTC spending for thrift resolution involves only an exchange of one asset or liability for another. These transfers of assets leave private income and wealth unchanged, and thus do not affect saving or consumption.

Excluding most RTC activities from the deficit calculations in the Balanced Budget Act would also be consistent with the treatment of asset sales under the act. The act excludes nonroutine asset sales from the budget baseline used to compute the spending cuts required under the automatic deficit reduction provisions. It is unclear whether RTC asset sales are covered by this exclusion. If they are, it would certainly make sense for the Congress also to exclude RTC's expenditures of working capital to acquire these assets.

The argument for excluding RTC activities from the Balanced Budget Act does not apply to its interest expenses. RTC's interest outlays are not merely an exchange of assets but represent a true increase in the government's costs. Table I-5 shows how the baseline and the

TABLE I-5. CBO BASELINE AND CBO ESTIMATE OF THE PRESIDENT'S BUDGET EXCLUDING NONINTEREST OUTLAYS OF THE RESOLUTION TRUST CORPORATION (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
			CBO Baseline			
Baseline Deficit	159	161	124	132	121	110
Resolution Trust Corporation (Except interest)	32	28	-17	-16	-12	-8
Baseline Deficit Excluding RTC	127	134	141	148	133	119
			President's Budget			
Deficit as Estimated by CBO	158	131	84	79	47	11
Resolution Trust Corporation (Except interest)	32	28	-17	-16	-12	-8
Deficit Excluding RTC	126	103	101	94	59	19

SOURCE: Congressional Budget Office.

CBO reestimate of the President's budget would be affected by removing RTC's noninterest outlays from the deficit calculation.

Excluding RTC, CBO estimates that the President's policies would produce a deficit of $103 billion in 1991. In 1992 and 1993 the deficit would hardly decline at all, but the budget would come close to balance by 1995. If reached, it would represent a substantial achievement. Compared with today's deficits, balancing the budget would increase national saving by 3 percent of GNP. Added saving will increase the productivity of the economy, raise the growth of living standards, and ease the strain of the baby boom's retirement 20 years hence.

CHAPTER II

COMPARISON OF ECONOMIC ASSUMPTIONS

The Administration's economic assumptions are more optimistic than those developed by the Congressional Budget Office. Over the 1991-1995 period, the Administration expects growth of real (inflation-adjusted) GNP to be higher, inflation rates to be lower, and both short- and long-term interest rates to be much lower than does CBO. Interest rates in the Administration's projections are lower because of both lower inflation and lower real interest rates.

The Administration's projections rest on two critical expectations that, while not implausible, may not be so easily realized. First, the Administration anticipates that its policies to reduce the deficit will be enacted and that this achievement, along with a credible monetary policy, will change the perceptions of financial markets substantially, which in turn will lead to lower interest rates. Second, the Administration expects that the growth of labor productivity will pick up--an assumption that accounts for most of the difference in the growth of output between the Administration's projections and CBO's. More rapid growth in productivity raises the Administration's estimate of the economy's potential growth rate to 3.0 percent a year, which is higher than CBO's estimate of 2.5 percent. The potential growth rate determines how fast an economy with full employment of labor and capital can grow without experiencing higher inflation.

Differences between the Administration's economic assumptions and those of CBO enable the Administration to project much lower deficits than does CBO. Indeed, substituting CBO's economic assumptions for the Administration's adds $26 billion to the deficit in fiscal year 1991 and $117 billion in fiscal year 1995. This chapter first describes differences between CBO and the Administration in their short-run economic outlooks and medium-term projections, then evaluates those differences, and lastly discusses the budgetary implications of the different economic assumptions.

SHORT-TERM OUTLOOKS

The differences in the short-term outlooks of CBO and the Administration for 1990 and 1991 are found mainly in two major economic indicators: growth of real GNP and interest rates (see Table II-1). CBO expects the growth in real GNP in both years to be 0.8 percentage point lower than the Administration does on a fourth-quarter-to-fourth-quarter basis. Although the forecasts of interest rates are similar in 1990, the forecasts differ substantially in 1991, with CBO's forecast of nominal short-term rates 1.8 percentage points higher and long-term rates 0.9 percentage point higher than the Administration's. The forecasts of nominal interest rates, especially short-term rates, differ primarily because of differences in the forecasts of real interest rates. In 1991, CBO expects inflation-adjusted (or real) short-term interest rates to be 1.4 percentage points higher than does the Administration.[1]

Forecast Comparisons

Although CBO forecasts sluggish economic growth in 1990, it expects the economy to avoid a recession, based largely on the assumption that the Federal Reserve will continue to encourage lower interest rates. Lower interest rates in turn stimulate housing and business investment. As a result, economic growth is expected to pick up in the last half of 1990, but not by much. By early 1991, the Federal Reserve is expected to encourage a rise in short-term interest rates, prompted by a concern that faster growth in an economy with few idle resources could lead to higher inflation. The Federal Reserve's anticipated efforts to control inflation help to reduce the spread between long-term and short-term rates in 1991, making the spread similar to what it was in 1989, when the Federal Reserve also encouraged a rise in interest rates.

Because the Administration expects growth in productivity to pick up, it is able to forecast relatively rapid economic growth without

1. Real interest rates are the difference between nominal interest rates and expected inflation. Because expectations of inflation in the financial markets are unobservable, most analysts--including CBO--approximate real interest rates by adjusting nominal interest rates by actual inflation.

TABLE II-1. COMPARISON OF CBO, ADMINISTRATION, AND *BLUE CHIP* SHORT-RUN ECONOMIC FORECASTS (By calendar year)

	Actual 1988	Estimated 1989	Forecast 1990	Forecast 1991
Fourth Quarter to Fourth Quarter (Percentage change)				
Real Gross National Product				
CBO	3.4	2.5	1.8	2.5
Administration	3.4	2.7	2.6	3.3
Blue Chip	3.4	2.4	1.9	2.4
Implicit GNP Deflator				
CBO	4.0	3.9	4.1	4.0
Administration	4.0	4.0	4.2	4.1
Blue Chip	4.0	3.8	4.1	4.0
Consumer Price Index[a]				
CBO	4.3	4.6	4.1	4.4
Administration	4.2	4.4	4.1	4.0
Blue Chip	4.3	4.6	4.3	4.3
Calendar Year Average (Percent)				
Civilian Unemployment Rate[b]				
CBO	5.5	5.3	5.6	5.5
Administration	5.4	5.2	5.4	5.3
Blue Chip	5.5	5.3	5.6	5.6
Three-Month Treasury Bill Rate				
CBO	6.7	8.1	6.9	7.2
Administration	6.7	8.1	6.7	5.4
Blue Chip	6.7	8.1	7.3	7.3
Ten-Year Government Note Rate				
CBO	8.8	8.5	7.8	7.7
Administration	8.8	8.5	7.7	6.8
Blue Chip[c]	8.8	8.5	7.9	7.9
Inflation-Adjusted Three-Month Treasury Bill Rate[d]				
CBO	2.4	3.5	2.8	2.8
Administration	2.4	3.7	2.6	1.4
Blue Chip	2.4	3.5	3.0	3.0
Spread Between Ten-Year Government Note Rate and Three-Month Treasury Bill Rate				
CBO	2.1	0.4	0.9	0.5
Administration	2.1	0.4	1.0	1.4
Blue Chip	2.1	0.4	0.6	0.6

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (February 10, 1990).

NOTE: The CBO forecast is based on data available through December 1989 and does not reflect the fourth-quarter data for GNP or CPI published in January 1990. The *Blue Chip* forecast is an average of 50 private forecasters.

a. Consumer price index for all urban consumers (CPI-U) for CBO and the *Blue Chip*; consumer price index for urban wage earners and clerical workers (CPI-W) for the Administration.

b. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO projection is for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage point below the rate for the civilian labor force alone.

c. *Blue Chip* does not project a 10-year note rate. The values shown here are based on the *Blue Chip* projection of the Aaa bond rate, adjusted by CBO to reflect the estimated spread between Aaa bonds and 10-year government notes.

d. Inflation-adjusted interest rates are nominal rates less the fourth-quarter-to-fourth-quarter percentage change in the CPI-U.

higher inflation or rising interest rates. In 1990, the Administration anticipates that the economy will grow somewhat more slowly than its estimate of potential growth, which widens the gap between actual and potential output. In 1991, however, the Administration forecasts that the economy will grow faster than the potential growth rate, which closes some of the gap between actual and potential output, though not by enough to increase inflation. Real short-term interest rates in 1991 decline sharply in the Administration's forecast. This assumption presumably derives from two factors: with rising productivity growth, the Federal Reserve would see less need to restrain the economy, and with the enactment of the President's proposals to cut the deficit in 1991, financial markets would become convinced that the federal government's demand for credit was clearly on a downward trend.

MEDIUM-TERM PROJECTIONS

Neither the CBO nor the Administration attempts to forecast developments in the economy past 1991. Instead, both organizations rely primarily on mechanical extrapolations of historical trends to develop the medium-term projections for the years from 1992 through 1995. There are two major differences, however, in the approaches of CBO and the Administration in developing these medium-term projections: first, the Administration chooses a different historical reference period than CBO when deciding the projected rate of growth in productivity; and second, the Administration explicitly incorporates the effects of prospective changes in economic policy, while CBO relies solely on historical trends.

Overall, the differences between the CBO and the Administration's medium-term projections can be summarized as follows (see also Table II-2 and Figure II-1):

- o The Administration assumes that economic growth over the 1992-1995 period will average about two-thirds of a percentage point higher than in the CBO projection;

- o The Administration assumes that rates of inflation will drop substantially, while CBO assumes that they will remain at the levels expected for 1991;

- o Nominal interest rates in the Administration's projections are much lower than in CBO's, because of both lower real interest rates and lower inflation; and

- o The Administration's projected level of nominal GNP is higher than CBO's in all years, with the difference rising from $109 billion in 1991 to almost $200 billion in 1995.

Projections of Economic Growth

In CBO's medium-term projections, the growth rate of the economy is based on an accounting of three fundamental factors: the growth of the total number of workers in the labor force, the amount produced (or productivity) by each worker, and the change in the gap between actual employment and full employment, which is related to the change in the gap between actual output and potential output.[2] In the CBO projections, growth in the labor force is based on the middle of three alternative projections made by the Bureau of Labor Statistics.[3] Between now and the turn of the century, the labor force is expected to grow at an annual rate of only 1.2 percent--below the rate of 1.6 percent since 1980. CBO also assumes that the growth in nonfarm business productivity will average 1.4 percent annually, which is its average growth since 1981. CBO's projection methods further assume that levels of output by 1995 will reflect the average gap between actual and potential output observed in the post-World War II period. Since these historical numbers include both expansions and recessions, the projections are consistent with the occurrence of a mild recession sometime during the 1992-1995 period.[4]

The Administration also bases its projections on assumptions of growth in the labor force and productivity, and of the gap between actual and potential output. While the Administration and CBO as-

2. Changes in hours per worker, which also enters into this accounting, have only a minor effect on the growth of output.

3. For more details, see Howard Fullerton, "New Labor Force Projections, Spanning 1988 to 2000," *Monthly Labor Review* (November 1989).

4. For details on the methodology of CBO's medium-term projections, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1989-1993* (February 1988).

25-692 O - 90 - 2

TABLE II-2. COMPARISON OF CBO, ADMINISTRATION, AND *BLUE CHIP* ECONOMIC ASSUMPTIONS, CALENDAR YEARS 1989-1995

	Estimated	Forecast		Projected			
	1989	1990	1991	1992	1993	1994	1995
Nominal GNP (Billions of dollars)							
CBO	5,235	5,534	5,893	6,279	6,688	7,121	7,579
Administration	5,236	5,583	6,002	6,439	6,881	7,324	7,771
Real GNP (Percentage change, year over year)							
CBO	2.9	1.7	2.4	2.5	2.5	2.4	2.4
Administration	3.0	2.4	3.2	3.2	3.1	3.0	3.0
Blue Chip	2.9	1.6	2.4	3.1	3.0	2.6	2.5
Consumer Price Index[a] (Percentage change, year over year)							
CBO	4.8	4.0	4.3	4.3	4.3	4.3	4.3
Administration	4.8	3.9	4.0	3.9	3.6	3.3	3.0
Blue Chip	4.8	4.3	4.2	4.3	4.3	4.3	4.2
Implicit GNP Deflator (Percentage change, year over year)							
CBO	4.2	4.0	4.0	4.0	4.0	4.0	4.0
Administration	4.2	4.1	4.2	3.9	3.6	3.3	3.0
Blue Chip	4.2	4.0	4.0	4.1	4.1	4.2	4.1
Unemployment Rate[b]							
CBO	5.3	5.6	5.5	5.5	5.5	5.5	5.5
Administration	5.2	5.4	5.3	5.2	5.1	5.0	5.0
Blue Chip	5.3	5.6	5.6	5.6	5.4	5.3	5.2
Tax Bases (Billions of dollars)							
Wage and Salary Disbursements							
CBO	2,630	2,795	2,975	3,168	3,377	3,599	3,835
Administration	2,626	2,805	3,022	3,246	3,469	3,686	3,904
Other Personal Income[c]							
CBO	1,796	1,886	2,001	2,123	2,253	2,385	2,524
Administration	1,798	1,896	2,017	2,138	2,261	2,393	2,525
Corporate Profits[d]							
CBO	294	320	356	371	386	414	438
Administration	303	360	421	472	515	548	579

(Continued)

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators.*

TABLE II-2. Continued

	Estimated	Forecast		Projected			
	1989	1990	1991	1992	1993	1994	1995
Three-Month Treasury Bill Rate (Percent)							
CBO	8.1	6.9	7.2	6.9	6.5	6.1	5.8
Administration	8.1	6.7	5.4	5.3	5.0	4.7	4.4
Blue Chip	8.1	7.3	7.3	6.9	7.0	6.9	6.8
Ten-Year Government Note Rate (Percent)[e]							
CBO	8.5	7.8	7.7	7.6	7.5	7.4	7.3
Administration	8.5	7.7	6.8	6.3	6.0	5.7	5.4
Blue Chip	8.5	7.9	7.9	7.9	7.8	7.9	7.9
Inflation-Adjusted Three-Month Treasury Bill Rate[f]							
CBO	3.5	2.8	2.8	2.6	2.2	1.8	1.5
Administration	3.7	2.6	1.4	1.5	1.5	1.5	1.5
Blue Chip	3.5	3.0	3.0	2.6	2.7	2.6	2.6
Spread Between Ten-Year Government Note and Three-Month Treasury Bill Rate							
CBO	0.4	0.9	0.5	0.7	1.0	1.3	1.5
Administration	0.4	1.0	1.4	1.0	1.0	1.0	1.0
Blue Chip	0.4	0.6	0.6	1.0	0.8	1.0	1.1

NOTE: The CBO forecast is based on data available through December 1989 and does not reflect fourth-quarter data for GNP or CPI published in January 1990. The *Blue Chip* forecasts through 1991 are based on a survey of 50 private forecasters, published on February 10, 1990. The *Blue Chip* projections from 1992 through 1995 are based on a survey of 41 forecasters, published on October 10, 1989.

a. Consumer price index for all urban consumers (CPI-U) for CBO and the *Blue Chip*; consumer price index for urban wage earners and clerical workers (CPI-W) for the Administration.

b. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO projection is for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage point below the rate for the civilian labor force alone.

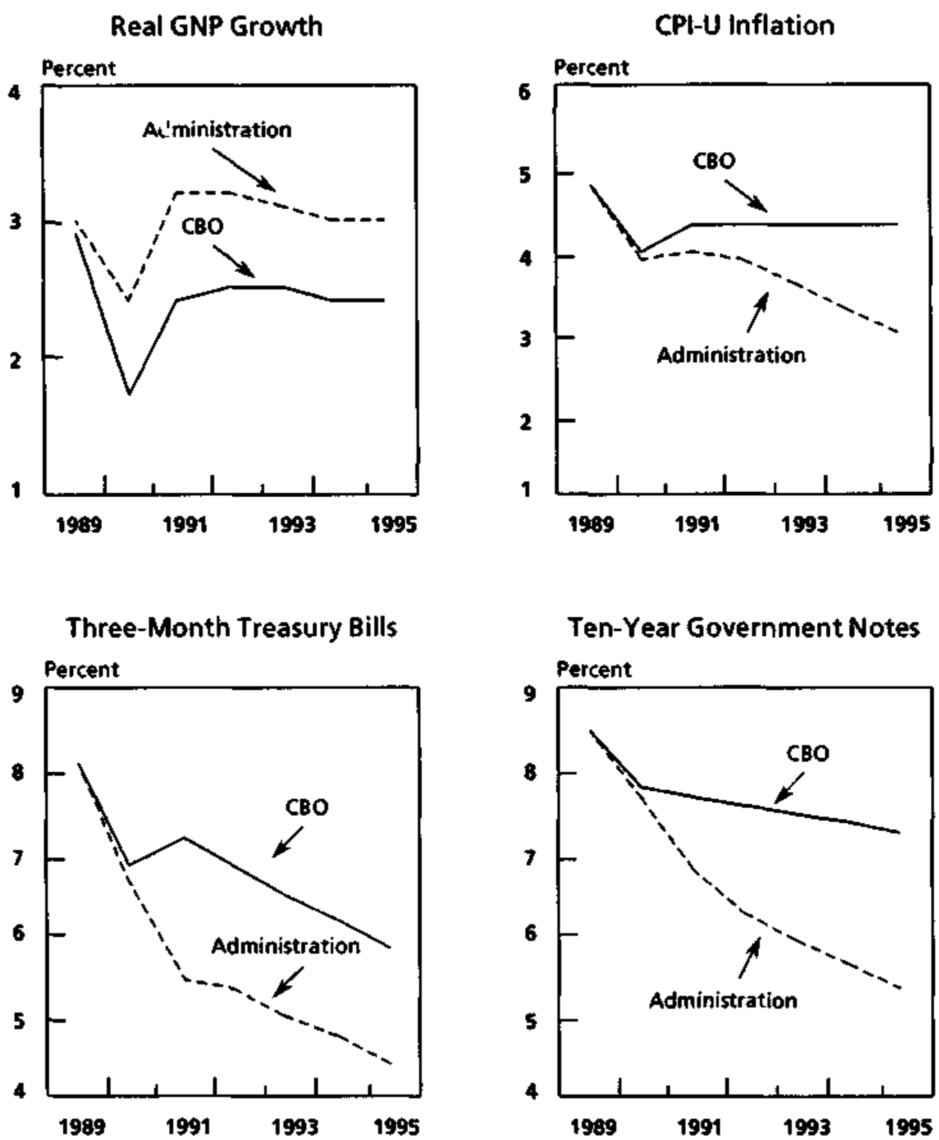
c. Personal income less wage and salary disbursements.

d. Corporate profits reported are book, not economic, profits.

e. *Blue Chip* does not project a 10-year note rate. The values shown here are based on the *Blue Chip* projection of the Aaa bond rate, adjusted by CBO to reflect the estimated spread between Aaa bonds and 10-year government notes.

f. Inflation-adjusted interest rates are nominal rates less the fourth-quarter-to-fourth-quarter percentage change in the CPI-U, except for the *Blue Chip* projections from 1992 through 1995 in which inflation-adjusted interest rates are nominal rates less the year-over-year percentage change of the CPI-U.

Figure II-1.
Comparison of CBO and Administration Economic Assumptions



SOURCE: Congressional Budget Office; Office of Management and Budget.

NOTE: CPI-U = consumer price index for all urban consumers.

sumptions are very similar for growth in the labor force, they differ substantially for productivity. From now until 1995, the Administration assumes that nonfarm business productivity will grow 1.8 percent annually, which is near its average for the post-World War II period and higher than CBO's assumption of 1.4 percent. The Administration assumes no gap between actual and potential output after 1993.

Projections of Inflation and Interest Rates

The inflation rate in the CBO projections is assumed to remain at its 1991 level. The rate of core inflation, as measured by the consumer price index for all urban consumers (CPI-U) less food and energy, has remained relatively close to this level over the past five years, and CBO does not project any shocks to food and energy prices. In the Administration's projections, an increase in the credibility of macroeconomic policies convinces wage and price setters in the economy that inflation is being rolled back, which lowers expectations of inflation and eventually inflation in the prices of goods and services as well.

In the CBO projections, real short-term interest rates are assumed to decline gradually in the 1992-1995 period to 1.5 percent, close to their average level observed since 1973. The spread between long-term and short-term interest rates also moves gradually to its historical average since 1973, which was the first year in which the exchange rate was allowed to fluctuate freely. Choosing a longer period for reference does not affect the calculation by much for either the real short-term interest rate or the spread.

The Administration expects that its policy of deficit reduction will have a powerful effect on expectations in the financial markets and, along with more accommodative monetary policy, will lead to sharp reductions in real interest rates in 1991. Real short-term rates fall to their historical levels in 1991 and remain at those levels throughout the projection period. A change in the perceptions of macroeconomic policies in the United States also causes the spread between long-term and short-term interest rates in the Administration's projections to fall sharply in 1992 to a level below its historical average since 1973. The spread presumably narrows because the President's policies, along with a continuation of credible monetary policy, create expectations of lower future inflation and less uncertainty in financial markets.

Projections of Nominal Income and Its Components

The Administration's assumptions of stronger real economic growth account for the large difference in nominal GNP between the two projections. About two-thirds of the additional nominal income in the Administration's projections goes to increased corporate profits, mainly because lower interest rates reduce the cost of corporate interest payments and boost operating profits. The Administration's projections of wage and salary disbursements are higher than CBO's, in part because of the assumption of higher productivity, which raises real wages.

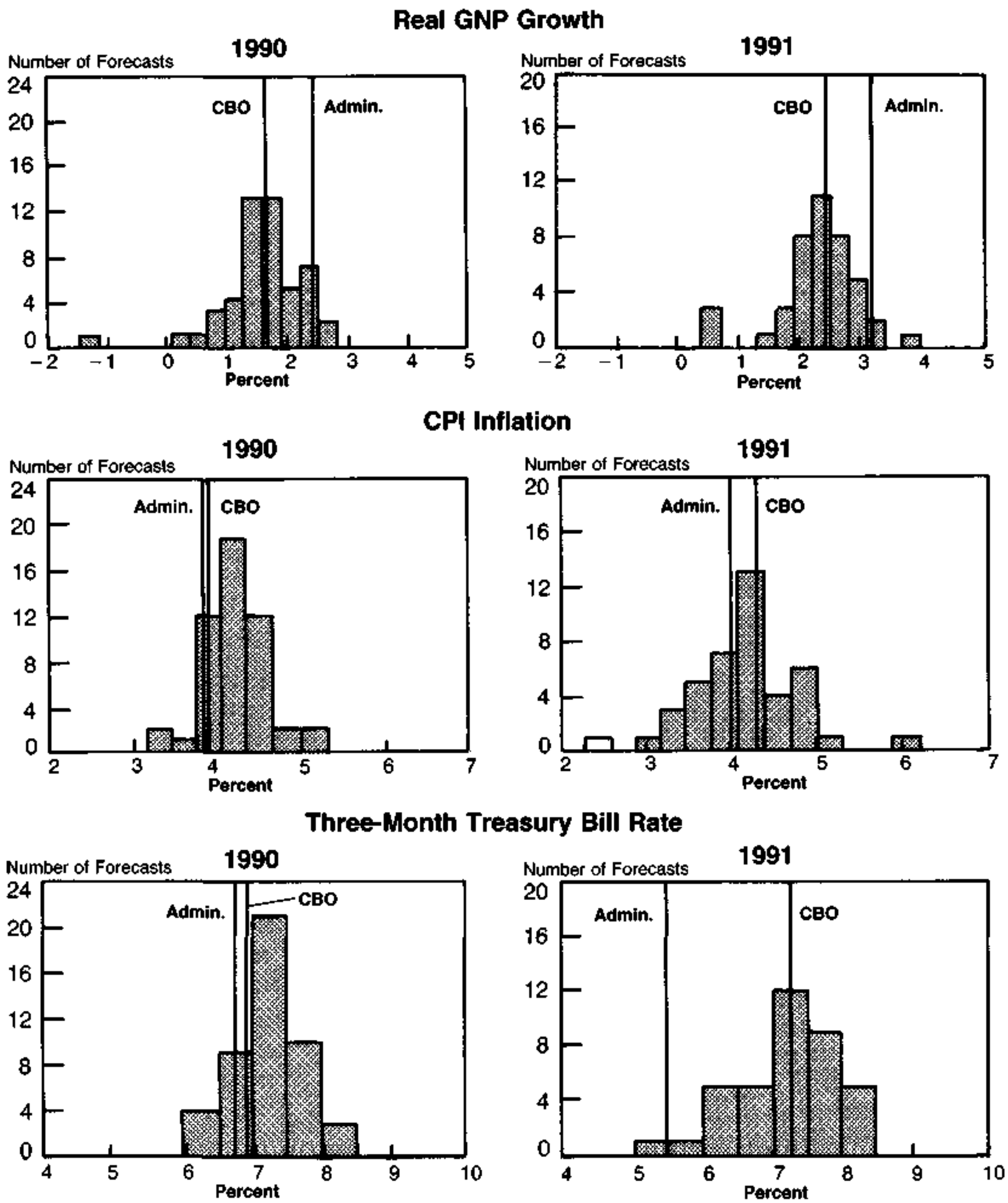
EVALUATING ECONOMIC ASSUMPTIONS

Evaluating the reasonableness of alternative economic outlooks is always a difficult task because of the uncertainty inherent in forecasting the future. One way to deal with this uncertainty is to evaluate forecasts using multiple criteria. This section evaluates the forecasts of CBO and the Administration using three criteria: a comparison with many private forecasts; an analysis of previous forecasting and projection errors; and an examination of the reasonableness of fundamental assumptions. On the basis of these three criteria, the CBO forecast appears more prudent than the Administration's. Nevertheless, the Administration's forecast is not unreasonable, especially given the size of the average forecast error in the recent past.

Comparison with Forecasts from the Private Sector

Neither CBO's nor the Administration's forecast is far from the consensus of private forecasters for 1990, but the Administration's forecast is more optimistic than the consensus for 1991, especially in its forecast for interest rates (see Table II-1 and Figure II-2). In the February 10, 1990, *Blue Chip* survey of private forecasts for 1991, 39 out of 42 participants expected real growth to be weaker than the Administration's forecast, 32 out of 35 expected long-term interest rates to be higher, and 37 out of 38 expected short-term interest rates to be higher. In contrast, the CBO short-term forecast, which attempts to balance the possibilities of both more favorable and more unfavorable outcomes, is close to the consensus in both years.

Figure II-2.
CBO, Administration, and the Range of the *Blue Chip* Forecasts for Calendar Years 1990 and 1991



SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (February 10, 1990).

Over the 1992-1995 projection period, the *Blue Chip* consensus for real GNP growth is about halfway between the CBO and the Administration projections on average (see Table II-2). At the same time, the *Blue Chip* projection of interest rates is higher than CBO's and much higher than the Administration's. In the first two years of this period, the Administration's projection of real economic growth is closer than CBO's to the *Blue Chip*; in the last two years of the projection period, CBO's projection of real economic growth is closer than the Administration's to the *Blue Chip*. The *Blue Chip* projection of fast economic growth in the first two years of the projection period, however, is accompanied by high interest rates--a projection that is much different from the Administration's.

The Track Records of CBO and the Administration

In defending its relatively optimistic forecast, the Bush Administration has pointed to the accuracy of its forecast for calendar year 1989, made during the mid session review. While this forecast was right on the mark for many variables, despite being more optimistic than the *Blue Chip* average, it is not a sure indicator of forecasting accuracy.[5] For one thing, because it was made in July, it involved only six months. Accuracy in forecasting six months ahead, when forecasters differ by little, is not necessarily a good indicator of accuracy in forecasting one or two years ahead, when differences are substantial.

A larger sample--the experience of the last 12 years--shows that CBO has compiled smaller errors than previous Administrations in forecasting a majority of the most important economic variables. For the two variables that affect the forecasts of the budget deficit most strongly--real GNP and inflation-adjusted interest rates--CBO's short-term forecasts have been somewhat better on average.[6] In the medium-term projections, CBO's projections of these variables have a larger edge over the Administration's. The record is described more fully in

5. CBO's forecast for 1989, made six months earlier in the beginning of that year, was also right on the mark for many of the same variables.

6. The differences in assumptions on inflation rates do not cause major differences in estimates of the deficit. Higher inflation increases the costs of federal programs with cost-of-living adjustments and raises interest rates, but also increases nominal incomes and the tax base. For more details, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1991-1995* (January 1990).

Appendix B. Still, the historical record is short, and the differences between CBO and previous Administrations have been too small to suggest that either the present Administration or CBO is likely to enjoy a decided advantage in future accuracy.

Evaluating the Reasonableness of the Fundamental Assumptions

CBO believes that the two fundamental assumptions on which the Administration's forecast is based this year are open to question. The first assumption involves the growth of productivity, and the second deals with the effects of the deficit reduction in the President's budget on expectations in the financial markets and interest rates.

Growth of Potential Output and Productivity. The Administration's assumption of nonfarm business productivity is close to the average annual rate of the series--1.9 percent--over the post-World War II period. The choice of the historical reference period, however, is particularly vital for the assumption of productivity growth, since the average rate of growth of productivity is widely thought to have shifted significantly several times during the post-World War II period (see Table II-3). In the 1970s and 1980s, growth of productivity was substantially below the post-World War II average. The Administration notes that productivity grew at a 1.8 percent rate during the 1986-1988 period. But productivity was unusually strong in these years for special and temporary reasons, mostly the result of the rebound in economic activity from the manufacturing slump of 1985 to 1986. Furthermore, a three-year period represents too short an interval to establish a new trend, especially in light of the poor performance in 1989, when labor productivity grew by less than 1 percent.

In contrast, CBO assumes that nonfarm business productivity will grow 1.4 percent annually, close to its average since 1981. Using the period since 1981 seems reasonable, primarily because the latest shift in the growth of productivity appears to have started sometime in the late 1970s or early 1980s. Moreover, the period is long enough to en-

TABLE II-3. GROWTH OF NONFARM BUSINESS PRODUCTIVITY (In percent)

	Average Annual Growth
Actual Growth	
1948:IV through 1989:IV	1.9
1948:IV through 1973:IV	2.4
1973:IV through 1981:III	0.6
1981:III through 1989:IV	1.4
Projected Growth Assumptions	
Administration	1.8
CBO	1.4

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Labor, Bureau of Labor Statistics.

compass both a recession and an expansion. CBO's projections of productivity also appear similar to those of the Federal Reserve.[7]

Despite extensive research, economists have not been able to explain or predict a large fraction of the swings in productivity growth in the post-World War II period. It is even harder to predict with confidence whether future growth will be above current rates. Although several factors might lead to an increase in the growth of productivity in the near future, other factors could lead to a slowdown. Two demographic developments are expected to increase the growth of productivity. First, the labor force is expected to grow at a much slower rate over the next 10 years than it has over the past 10 years. This slower

7. The Federal Reserve does not publish its projections of the growth of productivity. But its estimates of the growth of potential output are very close to CBO's, which implies a similar estimate for productivity if the Federal Reserve uses a similar estimate of labor force growth--not an unreasonable supposition given that projections of labor force growth differ little among forecasters.

growth of the labor force will raise the amount of capital that each worker has available, given the current rate of national saving. Second, the aging of the baby-boom generation will increase the maturity and experience of the work force, thereby raising productivity.

At the same time, two other factors suggest that productivity growth will not pick up. First, growth of productivity during the 1980s has been helped by a decline in energy prices. No such decline--or for that matter any other favorable "supply shock"--is expected in either the CBO or Administration projections. Second, the shift toward shorter-lived capital goods, such as computers, probably helped productivity growth in the 1980s, but it is not expected to do so in subsequent decades. A shift to shorter-lived capital goods for a given amount of investment causes aggregate capital services to rise temporarily. Over time, however, capital services decline to a level below their initial value.[8]

Effects of Fiscal Policies on Expectations and Interest Rates. Expectations clearly play important roles in financial markets. But the President's proposals to cut the deficit and extend the budget targets beyond 1993 may not generate enough enthusiasm in financial markets to cause real interest rates to fall substantially in 1991. The proposed cuts for 1991 include some one-time-only reductions, and some whose impact CBO and other analysts believe to have been overstated in the President's budget. Although the Administration has also proposed setting new budget targets that call for large budget surpluses, it has not released any detailed plan for reducing the deficit beyond 1991, other than assuming high rates of economic growth and low interest rates. Many analysts believe that, because of a history of unfulfilled projections of lower deficits, financial markets are and will continue to be skeptical about the future course of budget policy in the United States. Until there is evidence of a sustained action to reduce the

8. For a description of how changes in the durability of capital goods affect aggregate capital services, see Frank DeLeeuw, "Interpreting Investment-to-Output Ratios: Nominal/Real, Net/Gross, Stock/Flow, Narrow/Broad," Carnegie-Rochester Conference Series on Public Policy (forthcoming); and A.J. Katz, "Conceptual Issues in the Measurement of Economic Depreciation, Capital Input, and the Net Capital Stock," Discussion Paper 30, Bureau of Economic Analysis, U.S. Department of Commerce (1989).

TABLE II-4. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S BUDGET (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
Revenues	-1	-19	-36	-55	-64	-63
Outlays						
Benefit programs	a	1	1	3	5	9
Interest costs						
As a result of of interest rates	-1	5	13	18	20	21
Debt service	a	1	4	9	16	24
Total	-a	7	18	29	41	54
Deficit	a	26	54	84	105	117

SOURCE: Congressional Budget Office.

NOTES: Each entry in the table represents the difference between an estimate based on CBO's economic assumptions and the corresponding projection reported in the Administration's budget.

The totals include Social Security, which is off-budget.

a. Less than $0.5 billion.

deficit, financial markets will probably be unwilling to bid up the prices of bonds enough to permit a sharp decline in real interest rates.[9]

IMPLICATIONS OF ECONOMIC ASSUMPTIONS FOR DEFICITS

Administration economic assumptions imply somewhat lower levels of federal spending, much higher levels of tax revenue, and, as a result, significantly lower deficits for fiscal years 1990 through 1995 than those projected by CBO. Higher nominal incomes raise revenues, and lower interest rates reduce interest payments on federal debt. Substituting CBO's economic assumptions for the Administration's adds

9. For a detailed discussion of the effects of deficits on interest rates, see Congressional Budget Office, "Deficits and Interest Rates: Theoretical Issues and Empirical Evidence," Staff Working Paper (January 1989); and Congressional Budget Office, "Deficits and Interest Rates: Theoretical Issues and Simulation Results," Staff Working Paper (January 1989).

$26 billion to the deficit in fiscal year 1991 and $117 billion to the deficit in fiscal year 1995, as shown in Table II-4 on page 32. Further details on the effects of different economic assumptions for revenue estimates are provided in Chapter III. The effects of different interest rate and inflation assumptions are discussed in Chapter V.

CHAPTER III

THE ADMINISTRATION'S REVENUE PROPOSALS

The Congressional Budget Office (CBO) estimates total Administration budget revenues at $1,146 billion in 1991, $1,208 billion in 1992, and $1,440 billion in 1995. Revenues would equal 19.8 percent of GNP in 1991, falling to 19.5 percent in 1992 and 19.3 percent in 1994 and 1995 (see Table III-1).

The President's budget contains a number of proposals affecting revenues. They include increased coverage of workers by payroll taxes, increased excise taxes and fees, management initiatives at the Internal Revenue Service (IRS), a capital gains exclusion, new Family Savings Accounts (FSAs), certain new income tax preferences, and extensions of expiring income tax deductions and credits. Except for a temporary increase in revenues from a spurt in realizations of capital gains in 1990 and 1991, deficit reduction results from increases in payroll taxes, excise taxes, and fees that more than offset the income tax reductions. CBO estimates that these proposals would raise $9 billion in 1991, $4 billion in 1992, and $2 billion in 1995 (see Table III-2).

REVENUE PROPOSALS

The proposals discussed in this chapter are those classified as revenues in the unified budget. Although the President's budget revenues include these same proposals, the discussion of receipts in the President's budget document also includes user fees and offsetting collections. Because these are classified as outlays in the unified budget, this report analyzes them in its discussion of specific outlay functions (see Chapter V). The revenue effects of the proposals have been estimated jointly by CBO and the Joint Committee on Taxation.

TABLE III-1. ADMINISTRATION AND CBO ESTIMATES OF ADMINISTRATION BUDGET REVENUES, BY MAJOR SOURCE (By fiscal year, in billions of dollars)

Revenue Source	1990	1991	1992	1993	1994	1995
			Administration Estimates			
Individual Income Taxes	489.4	528.5	561.5	593.6	632.4	668.7
Corporate Income Taxes	112.0	129.7	140.6	154.7	159.9	169.7
Social Insurance Taxes and Contributions						
On-budget	99.9	106.9	112.3	119.5	126.2	131.8
Off-budget[a]	285.4	314.5	337.4	361.9	388.4	410.7
Excise Taxes	36.2	37.6	39.2	40.8	42.2	43.7
Other	50.5	53.0	55.4	57.1	59.6	61.8
Total Revenues	1,073.5	1,170.2	1,246.4	1,327.6	1,408.6	1,486.3
Percentage of GNP	19.6	19.9	19.7	19.6	19.5	19.4
			CBO Estimates			
Individual Income Taxes	490.8	529.8	556.8	592.5	631.5	673.2
Corporate Income Taxes	102.0	110.1	114.4	117.7	122.9	130.2
Social Insurance Taxes and Contributions						
On-budget	99.9	104.6	109.2	114.2	120.6	126.7
Off-budget[a]	287.8	311.3	332.7	353.2	378.5	403.3
Excise Taxes	36.1	38.1	39.4	40.9	42.4	43.8
Other	51.2	52.5	55.2	57.7	60.3	62.8
Total Revenues	1,067.7	1,146.4	1,207.8	1,276.3	1,356.2	1,440.0
Percentage of GNP	19.6	19.8	19.5	19.4	19.3	19.3

SOURCES: Office of Management and Budget, *Budget of the United States Government, Fiscal Year 1991* (January 1990); Congressional Budget Office revenue estimates.

a. Off-budget revenues consist of those from Old-Age, Survivors, and Disability Insurance (OASDI) trust funds.

Savings and Investment Incentives

The Administration offers three tax proposals to increase personal saving and encourage certain investment activities (see Table III-3). These three proposals are included with others that increase public saving by reducing the deficit.

TABLE III-2. CBO ESTIMATES OF REVENUE PROPOSALS IN THE ADMINISTRATION'S 1991 BUDGET
(By fiscal year, in billions of dollars)

Proposal	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline Revenues	1,137.0	1,203.8	1,276.7	1,354.6	1,437.8	
Proposed Changes						
Savings and investment incentives	2.6	-5.1	-4.7	-5.7	-5.0	-17.9[a]
Extensions of expiring income tax provisions	-1.8	-2.7	-3.1	-3.5	-3.9	-15.0
Oil and gas industry incentives	-0.3	-0.5	-0.5	-0.6	-0.6	-2.5
Payroll tax increases[b]	4.6	6.1	1.0	4.2	4.4	20.3
Excise tax and fee increases[c]	3.5	5.5	6.0	6.5	7.0	28.4
Internal Revenue Service initiatives	0.3	0.4	1.0	1.2	1.2	4.1
Other revenue proposals	0.5	0.4	d	-0.5	-0.9	-0.5[e]
Total[c]	9.4	4.0	-0.4	1.6	2.3	16.8[a, e]
President's Budget Revenues as Estimated by CBO	1,146.4	1,207.8	1,276.3	1,356.2	1,440.0	

SOURCES: Congressional Budget Office and Joint Committee on Taxation revenue estimates.

a. Excludes a revenue increase of $0.7 billion in 1990 from the proposed capital gains exclusion.

b. Revenues are net of reduced income taxes.

c. Revenues are net of reduced income and payroll taxes.

d. Revenue decrease of less than $50 million.

e. Excludes a revenue increase of $0.2 billion in 1990 for the proposed change to loss deductions claimed by insurance companies.

Exclude 30 Percent of Capital Gains. The Administration proposes to reduce the personal income tax rate on most long-term capital gains by allowing individuals to exclude a percentage of capital gains that are realized on qualifying assets. The percentage would increase with the holding period: 10 percent for assets held one to two years, 20 percent for assets held two to three years, and 30 percent for assets held over three years. Thus, the marginal tax rate on capital gains on qualifying assets held for more than three years would be 23.1 percent for taxpayers in the 33 percent tax bracket, 19.6 percent for taxpayers in the 28 percent bracket, and 10.5 percent for taxpayers in the 15 percent bracket. The exclusion would apply to all capital assets except collectibles (for example, antiques and precious metals). The excluded portion of capital gains would be considered a tax preference under the alternative minimum tax (AMT), which means that taxpayers subject to the AMT would face an effective tax rate on capital gains of 21 percent. Depreciation deductions would be recaptured as ordinary income; in

TABLE III-3. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSED SAVINGS AND INVESTMENT INCENTIVES (By fiscal year, in billions of dollars)

Proposal	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
Exclude 30 Percent of Capital Gains	3.2	-4.3	-3.6	-4.3	-3.1	-12.0[a]
Establish Family Savings Accounts	-0.3	-0.6	-1.0	-1.3	-1.8	-5.1
Waive the Penalty for Early Withdrawals from IRAs for First-Time Homebuyers	-0.2	-0.2	-0.2	-0.1	-0.1	-0.9
Total	2.6	-5.1	-4.7	-5.7	-5.0	-17.9[a]

SOURCES: Congressional Budget Office and Joint Committee on Taxation revenue estimates.

NOTE: IRA = individual retirement account.

a. Excludes a revenue increase of $0.7 billion in 1990.

other words, only the excess of the sales price over the original basis would qualify for the exclusion.

The capital gains exclusion would apply to capital gains realized after March 15, 1990. The two- and three-year holding period requirements would be phased in over three years. In 1990, all qualifying assets held for over one year would be eligible for the 30 percent exclusion. In 1991, assets held for over two years would be eligible for the 30 percent exclusion; assets held for over one year would receive a 20 percent exclusion. The full sliding scale described above would take effect in 1992. The phase-in, by allowing the full 30 percent exclusion for assets held less than three years in 1990 and 1991, would encourage sales of assets during the first two years of the budget period and increase short-run receipts.

CBO estimates that the proposal would raise $3.2 billion in 1991 and lose $3 billion to $4 billion in each succeeding year. The net loss from 1991 to 1995 would total $12.0 billion. This estimate is $24.0 billion below the Administration's estimate primarily because the Administration assumes that taxpayers are more responsive to changes in capital gains tax rates than CBO research suggests.[1]

Establish Family Savings Accounts. The Administration proposes to create a new tax-favored saving vehicle called the Family Savings Account. Under the proposal, taxpayers would be allowed to make nondeductible contributions of up to $2,500 annually to individual accounts, and the investment income of amounts left on deposit for at least seven years would be tax free. The investment income of amounts left on deposit between three and seven years would be subject to income tax but no penalty. A 10 percent penalty on investment income would be added for amounts left on deposit less than three years.

Eligibility to contribute to FSAs would be limited to people with adjusted gross income below certain levels--$60,000 for single taxpayers, $100,000 for heads of households, and $120,000 for couples filing joint returns. As with an individual retirement account (IRA), contributions to an FSA could not exceed a person's earnings or the

1. Congressional Budget Office, *How Capital Gains Tax Rates Affect Revenues: The Historical Evidence* (March 1988).

$2,500 contribution limit. Couples filing jointly, however, could each contribute up to $2,500 provided their total contributions did not exceed their combined earnings. For example, a couple in which one spouse worked outside the home earning $30,000 could contribute up to $2,500 to each of two accounts for a total of $5,000. Dependents would be ineligible.

FSAs could be invested in the same financial instruments as IRAs, and contributions could be made to them in addition to any other tax-advantaged saving for which a person qualified, such as an IRA, Keogh plan, employer pension, or 401(k) plan.

CBO estimates that the Treasury would lose about $300 million in revenues from FSAs during 1991, and that the loss would cumulate to $5.1 billion by 1995. This estimate is close to the Administration's estimate.

The revenue loss from FSAs would continue to grow rapidly after 1995 as people shifted otherwise taxable savings into these accounts. If people ultimately shifted 10 percent of their taxable savings into FSAs, the annual revenue loss, measured in 1991 dollars, would reach about $8 billion. If they shifted as much as one-quarter of their taxable savings into FSAs, the annual revenue loss would reach $20 billion (in 1991 dollars).

Waive the Penalty for Early Withdrawals from IRAs for First-Time Homebuyers. The Administration proposes to waive the 10 percent penalty for premature IRA withdrawals used for the first purchase of a home, effective as of January 1, 1990. Those withdrawals would only be subject to income taxation, as are all IRA withdrawals under current law. Withdrawals for a first home purchase would be limited to $10,000 and the home purchased could cost no more than 110 percent of the median home price in its area.

CBO estimates the revenue loss from this proposal at more than $200 million in 1991 and about $900 million over the five-year period. The revenue loss decreases over the projection period--to about $100 million in 1995--because withdrawals from IRAs for home purchases are assumed to begin before the end of the period. The Administration estimates that the losses would be smaller, based on the assumption

that fewer new contributions would be diverted from otherwise taxable savings.

The Proposals' Saving Incentives. Each of the proposals would increase the return to saving, but to differing degrees for different people. The 30 percent capital gains exclusion would raise the inflation-adjusted after-tax return to asset appreciation by about one-quarter for typical investors today. Assets that pay income in the form of taxable capital gains represent at most one-third of all assets owned by households, so the higher rate of return on appreciating assets would raise the overall return to saving by about 8 percent. (This is equivalent to an increase in the before-tax rate of return from 8 percent to about 8.2 percent.) The return to saving would increase more for the highest-income taxpayers who invest more heavily in assets yielding taxable gains.

FSAs would raise the return to saving by more than would the proposed capital gains exclusion. Because FSAs would totally exempt investment earnings from taxation, the inflation-adjusted after-tax return on savings placed in FSAs would approximately double. (This is equivalent to an increase in the before-tax rate of return from 8 percent to about 11 percent.) This higher return would be earned on an additional dollar saved by many people eligible for FSAs because of the proposal's relatively high contribution limit and because the contributions could be in addition to any other tax-advantaged saving. Limiting eligibility for FSAs to people below certain income levels also helps to target the proposal on those most likely to have an incentive to increase their saving. Nonetheless, some eligible people would not have an incentive to save more because they regularly save more than the FSA limits in taxable accounts or because they have large asset accumulations that could be gradually shifted into FSAs.

Waiving the 10 percent tax on premature IRA withdrawals would allow people saving for their first home in deductible IRAs a tax-free rate, the same benefit they would receive from FSAs. Few people in any one year would benefit from this proposal because they must qualify both as making deductible IRA contributions and as first-time homebuyers. First-time buyers saving through nondeductible IRA contributions would benefit only from deferral of taxation rather than a tax-free return.

Effect of the Proposals on Personal Saving. Although the three proposals would raise the return to additional saving, they cannot be counted on to raise the personal saving rate significantly. An increased rate of return has two offsetting incentives--one that raises saving and another that reduces saving. On the one hand, a higher rate of return raises the amount of future spending that can be achieved per dollar saved now. This encourages people to save more, just as a lower price for a product encourages people to spend more on it. On the other hand, the higher return also means that previous levels of saving will allow an increase in future spending without further sacrifice. The availability of that higher future spending encourages people to divert some of the increase to current spending by saving less. The net effect of these offsetting incentives could be either to raise or to lower saving.

Most empirical studies of how people respond to increased rates of return on savings find that the incentives to increase and decrease saving are largely offsetting. These studies indicate that personal saving cannot be expected to respond much to the saving proposals. A few recent studies of the effects of IRAs in the 1980s suggest that these accounts raised saving, in part because contributions were deductible and the 10 percent penalty discouraged withdrawals before retirement. However, these studies have not resolved the issue of how much of IRA contributions were additional savings and how much were shifts of other savings into IRAs. Furthermore, the implications of these studies for FSAs are unclear because FSAs lack some of the special features that may have made deductible IRAs effective.

Effect of the Proposals on National Saving. Standing alone, the proposals would permanently lose revenue and raise the deficit. A larger deficit lowers national saving, so the proposals by themselves would raise national saving only to the extent they raised personal saving by more than they added to the deficit. Since studies indicate that any positive effects on personal saving are likely to be small, the proposals by themselves cannot be counted on to increase national saving.

If, however, these proposals were included in a package of other tax increases and spending reductions that reached a previously agreed-upon deficit reduction path, then the proposals would not be adding to the deficit. In this case, whatever increase the proposals and

the other elements of the package achieved in personal saving would add to national saving.

In sum, the three tax savings incentives taken alone would not be expected to add to national saving. Whatever personal saving they might stimulate would be offset by the revenue they would lose. As part of a long-run deficit reduction package, however, they could add to national saving.

Effects of the Capital Gains Proposal on Entrepreneurial Activity and Risky Investments. In addition to stimulating saving, the Administration advocates the capital gains exclusion as a means of encouraging entrepreneurial activity and high-risk investments. The proposal should provide an incentive for both of these activities, although it is not clear that the incentive is needed.

Proponents of the measure argue that some activities with large returns for society as a whole may not be pursued because the return that an entrepreneur can capture is small compared with the risk. They point out that current tax law places an extra burden on high-risk investment by limiting the deductibility of capital losses. This burden is greatest for people who are heavily invested in a single activity, such as their own businesses. Opponents reply that, although entrepreneurs may not capture all of the returns from some activities, the returns that they do receive provide sufficient incentive to undertake them. In addition, current law is not without incentives for entrepreneurial activity, including the deferral of taxation on the increasing value of a business until it is sold. Finally, most investors can protect themselves by diversifying their asset holdings so that losses on some investments can be offset against gains on other investments.

Even if entrepreneurial activity and risky investments need encouragement, the Administration's proposal is not focused closely on that end. The proposed capital gains exclusion would apply to gains on past investments whose supply cannot be affected; and it would apply to all new investments, only a small fraction of which are in new businesses.

Effect of the Proposals on the Distribution of Taxes. The proposals would provide most of their direct benefits to taxpayers in the upper half of the income distribution. According to the Joint Committee on

Taxation, taxpayers with incomes of more than $200,000 would receive 66 percent of the tax reductions arising from the capital gains tax exclusion.[2] Those with incomes above $50,000, who largely lost eligibility for deductible IRAs in 1987, would be the main beneficiaries of the FSAs. These two proposals would thus shift some of the tax burden from upper-income to lower-income taxpayers. The third proposal--to allow IRA withdrawals for first-time home purchasers--would be too limited to alter the distributional impact of the other two proposals.

Extension of Expiring Income Tax Provisions

Many tax deductions and credits enacted in recent years have included statutory termination dates. The Administration's budget for 1991 proposes to extend four of these provisions that are scheduled to expire by the end of 1990 (see Table III-4).

Extend the Research and Experimentation Credit. The Administration proposes to extend permanently the income tax credit for research and experimentation (R&E) expenses, currently scheduled to expire after December 31, 1990. The current tax credit for research and experimentation expenses allows business taxpayers to reduce their tax liability by 20 percent of the amount by which current R&E expenditures exceed a base amount computed with reference to the taxpayer's historical research expenditures. Expenditures that qualify for the credit include wages and costs of supplies used in research, a portion of contract research done by others and paid for by the taxpayer, and certain computer costs.

The R&E credit was enacted in the Economic Recovery Tax Act of 1981 as a four-year temporary credit and has been extended three times since then. Most recently, it was extended in the Omnibus Budget Reconciliation Act of 1989 for tax year 1990, although the benefits available for that year were reduced so that only three-quarters of a full year's benefit is available. The Administration's proposal would restore full benefits for tax year 1990. CBO estimates that permanent extension of the R&E credit would lose $0.9 billion in revenue in 1991 and a total of $7.0 billion in the 1991-1995 period.

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2. Joint Committee on Taxation, *Estimate of Administration Proposal for a Reduction in Taxes on Capital Gains of Individuals*, JCX-5-90 (February 14, 1990), Table 2.

Extend and Revise Research and Experimentation Allocation Rules. In addition to being eligible for the R&E credit, research and experimentation expenses can be deducted from current income as costs of doing business, like other business expenses. Companies that conduct operations both in the United States and abroad must allocate their R&E expenses to their various operations. Because taxes paid to foreign governments qualify the taxpayer for a foreign tax credit against U.S. tax liability on foreign-source income, companies with excess foreign tax credits have an incentive to increase their foreign-source income in order to increase the amount of foreign tax credits they may claim.

Current tax law provides that the minimum fraction of R&E expenses deductible from domestic income is 64 percent, but that is scheduled to fall to 30 percent in 1991. The Administration proposes to maintain the 64 percent rule permanently. Doing so allows fewer

TABLE III-4. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSED EXTENSIONS OF EXPIRING INCOME TAX PROVISIONS (By fiscal year, in billions of dollars)

Proposal	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
Extend the Research and Experimentation (R&E) Tax Credit	-0.9	-1.2	-1.4	-1.6	-1.8	-7.0
Extend and Revise R&E Allocation Rules	-0.4	-0.7	-0.8	-0.8	-0.9	-3.6
Extend the Partial Deduction for Health Insurance Premiums for the Self-Employed	-0.4	-0.5	-0.5	-0.6	-0.7	-2.7
Extend the Low-Income Housing Credit for One Year	-0.1	-0.3	-0.4	-0.4	-0.4	-1.7
Total	-1.8	-2.7	-3.1	-3.5	-3.9	-15.0

SOURCES: Congressional Budget Office and Joint Committee on Taxation revenue estimates.

deductions from foreign income, thus creating the opportunity for larger foreign tax credits to be claimed. CBO estimates that this proposal would reduce corporate tax receipts by $0.4 billion in 1991 and by $3.6 billion over the five-year period.

Extend the Partial Deduction for Health Insurance Premiums for the Self-Employed. The President proposes to make permanent the deduction allowed to self-employed taxpayers for 25 percent of the cost of providing health insurance for themselves and their families. Scheduled to expire on September 30, 1990, this deduction is designed to reduce the inequality between self-employed taxpayers and those employed by others. Employees whose health insurance is provided by their employers do not owe tax on the value of the insurance premiums. Self-employed people, in effect, owe tax on the value of their health insurance premiums because they are not allowed to deduct it as a cost of doing business. The partial deduction reduces by one-quarter the amount of tax they pay on the value of their insurance premiums. CBO estimates that permanent extension of the deduction would lose $0.4 billion in revenue in 1991 and $2.7 billion during the years from 1991 through 1995.

Extend the Low-Income Housing Credit. The Administration proposes to extend for one year the credit for certain expenditures made by the owners of low-income housing projects. Eligible expenditures include depreciable costs of new construction and renovation, and costs of acquiring certain old buildings. The Reconciliation Act extended the credit for one year through December 31, 1990, but the allowable credits for calendar year 1990 were reduced by one-quarter from the previous year's maximum. The Administration proposes to extend the credit through December 31, 1991, and to restore full benefits for 1990. CBO estimates that this would cost the Treasury almost $150 million in forgone revenue in 1991 and $1.7 billion over the five-year period.

Oil and Gas Industry Incentives

The Administration's budget proposes that four new tax preferences be provided to the energy industry. All of these provisions were proposed in last year's budget (see Table III-5).

Provide a Credit for Exploratory Intangible Drilling Costs. Independent oil producers are currently allowed to deduct intangible drilling costs (IDCs) for oil and gas wells as the costs are incurred. Integrated producers--mainly major oil companies--may deduct only a portion of these costs; they must capitalize the rest. The Administration proposes that all producers be allowed a 10 percent tax credit for the first $10 million of IDCs for exploratory drilling, coupled with a 5 percent credit for the remaining IDCs for exploratory drilling. The credit would be phased out if the average wellhead price of oil was $21 per barrel or higher for a full year, but neither CBO nor the Administration projects oil prices to be that high during the next five years.

The Administration's stated goal is to encourage exploratory drilling, but this proposal may allow some development expenses to be recharacterized as exploratory costs and thus become eligible for

TABLE III-5. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSED OIL AND GAS INDUSTRY INCENTIVES
(By fiscal year, in billions of dollars)

Proposal	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
Provide a Credit for Exploratory Intangible Drilling Costs (IDCs)	-0.2	-0.3	-0.4	-0.4	-0.4	-1.7
Reduce the Minimum Tax for Exploratory IDCs for Independent Producers	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Modify Depletion Rules	a	a	-0.1	-0.1	-0.1	-0.2
Provide a Credit for Initial Capital Costs for Tertiary Recovery	a	a	a	a	a	-0.1
Total	-0.3	-0.5	-0.5	-0.6	-0.6	-2.5

SOURCES: Congressional Budget Office and Joint Committee on Taxation revenue estimates.

a. Revenue decrease of less than $50 million.

greater tax benefits. CBO estimates that the forgone revenue would total $0.2 billion in 1991 and $1.7 billion over the five-year projection period.

Reduce the Minimum Tax for Exploratory Intangible Drilling Costs for Independent Producers. A portion of intangible drilling costs are considered a preference item for purposes of computing the minimum tax base. The Administration proposes to reduce by 80 percent the amount of drilling costs of independent producers that is considered a tax preference item. This reduction would allow many independent oil producers to deduct their drilling costs much more quickly. CBO estimates that this proposal would reduce revenues by about $0.1 billion per year, totaling $0.5 billion over five years.

Modify Depletion Rules. Current tax law allows cost recovery for investments in natural resources by means of depletion deductions. Integrated oil and gas producers are not eligible for the percentage depletion method, but independent producers are eligible. A provision of the tax code (the "transfer rule") prevents oil and gas reserves of integrated producers from being transferred to independent producers, and thus from becoming eligible for percentage depletion deductions. The Administration proposes to eliminate the transfer rule and to raise the limit on percentage depletion deductions from 50 percent to 100 percent of net income. CBO estimates that these changes in the depletion rules would lose a small amount of revenue in the budget year, but the revenue losses would cumulate to almost $250 million by 1995.

Provide a Credit for Initial Capital Costs for Tertiary Recovery. Tertiary recovery techniques are chemically enhanced injection processes used to produce oil and gas from properties that have become less productive using standard techniques. The President's budget would establish a 10 percent tax credit for capital expenditures on new tertiary recovery projects. The credit is intended to be limited to initial expenses, and would be phased out if the wellhead price of oil rose to $21 per barrel or higher. CBO estimates that this would reduce revenue by roughly $20 million annually, or $0.1 billion for the 1991-1995 period.

Payroll Tax Increases

The Administration proposes to expand the populations covered by certain payroll taxes that fund retirement benefit programs, to accelerate further the deadlines by which employers must remit withheld taxes, and to reduce and delay for three months the 1991 pay raise for federal employees. Several of these options have been proposed by the previous Administration in several budgets. (Pay raise reductions and delays have been allowed by the Congress without overriding legislation.) CBO estimates that these proposals, taken together, would raise $4.6 billion in 1991 and a total of $20.3 billion over the five-year period (see Table III-6).

TABLE III-6. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSED PAYROLL TAX INCREASES (By fiscal year, in billions of dollars)

Proposal	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
Require Social Security Contributions for State and Local Government Employees Not Covered by a Retirement Plan[a]	2.0	2.2	2.4	2.5	2.7	11.8
Require Medicare Contributions for All State and Local Government Employees[a]	1.7	1.7	1.6	1.6	1.6	8.2
Accelerate Deposit Deadlines for Withheld Income and Payroll Taxes	0.9	2.2	-3.1	0.0	0.0	0.0
Other Payroll Tax Proposals[a]	b	b	0.1	0.1	0.1	0.3
Total[a]	4.6	6.1	1.0	4.2	4.4	20.3

SOURCES: Congressional Budget Office and Joint Committee on Taxation revenue estimates.

NOTE: Revenues are net of reduced income taxes, except for the revenue effects of accelerated deposits of withheld taxes.

a. Benefit increases are not included.

b. Revenue increase of less than $50 million.

Require Social Security Contributions for Employees of State and Local Governments Who Are Not Covered by a Retirement Plan. The Administration would require all state and local government employees not covered under another retirement plan to contribute to Social Security (OASDI), beginning October 1, 1990. This proposal, included in the budget for the first time, would extend coverage to and mandate contributions from temporary workers such as students employed as summer interns, part-time workers, and workers who do not currently contribute but who expect to receive benefits through their spouses' participation. CBO estimates that required Social Security coverage for these state and local workers would raise $2.0 billion in additional revenue in 1991 and $11.8 billion in the 1991-1995 period. Increased benefit payments are likely to be small because most of these workers would qualify for Social Security benefits through other jobs or through their spouses' jobs.

Require Medicare Contributions for All State and Local Government Employees. Under current law, all employees of state and local governments hired after March 31, 1986, are required to pay Medicare's Hospital Insurance (HI) taxes. For the fourth year, the President's budget proposes to extend this requirement to all state and local government workers. The vast majority of the currently exempt workers already qualify for Medicare benefits because they have contributed to the system at other jobs or because their spouses are covered through their own employment. Although more than 90 percent of state and local government employees receive Medicare benefits in retirement, only 70 percent of them have paid Medicare taxes while employed in government jobs. Therefore, they receive benefits in return for a smaller amount of lifetime payroll taxes than paid by employees who work continuously in covered employment. CBO estimates that mandatory HI contributions from state and local government workers would raise $1.7 billion in 1991 and $8.2 billion over the budget projection period. Outlays for benefit payments would increase somewhat, but only $50 million of the increased costs would occur by 1995.

Accelerate Deposit Deadlines for Withheld Income and Payroll Taxes. The Omnibus Budget Reconciliation Act of 1989 accelerated the schedule on which large employers must deposit income and payroll taxes withheld on behalf of their employees. Current law requires that these employers remit withheld taxes on the first banking day after the taxes total $100,000 during 1990, and during 1993 through 1995. In

1991, such deposits must be made by the second banking day, and in 1992 by the third banking day. The President's budget would require large employers to deposit these taxes on the first banking day after they exceed the limit in all years. This proposal would not increase tax liabilities of workers or of employers; it would simply speed up the Treasury's receipt of these taxes. CBO estimates that this acceleration would increase revenues by $0.9 billion in 1991 and by $2.2 billion in 1992. Because these revenues would have been paid anyway, albeit a bit more slowly, future revenues would be decreased--by $3.1 billion in 1993. Because this is merely a speedup, these increases would not be counted for purposes of the Balanced Budget Act.

Other Payroll Tax Proposals. The Administration proposes four other payroll tax changes, the revenue effects of which are small. Taken together, CBO estimates that they would increase revenues by less than $50 million in 1991 and by $275 million in 1991 through 1995.

First, the President's budget would require that Social Security and Medicare coverage and contributions be extended to include all District of Columbia workers hired after December 31, 1990. Certain D.C. government workers in specialized occupations are covered under separate retirement plans, and therefore are currently exempt from paying Social Security and Medicare taxes. Second, the District of Columbia's employer contributions for cost-of-living allowances (COLAs) to the federal Civil Service Retirement program on behalf of current workers and retirees would be increased from approximately 7 percent of the COLA's cost to 11 percent in 1991 and 14 percent by 1994. Third, the budget proposes to extend through 1992 the status of commuter railway employers for unemployment insurance (UI) purposes. Through 1990, commuter railroads are allowed to reimburse the UI trust fund for actual unemployment compensation benefits paid to the railroads' former employees, rather than pay the 8 percent UI tax rate on their covered wage base. The proposal would extend this method through 1992, after which an experience-rated method of payment would be fully instituted. In addition, the reimbursable status would be extended to Amtrak, which is not currently allowed this method because it is not a commuter railroad. Fourth, the Administration plans to reduce and delay the 1991 pay raise for federal workers from the beginning of the fiscal year (October 1, 1990) to January 1, 1991.

Excise Tax and Fee Increases

The President's budget extends and increases several excise taxes, speeds up collection of one excise tax and changes the collection point of another, and imposes or increases a variety of fees. CBO estimates that these proposals would raise $3.5 billion in 1991; the revenue gains would cumulate to $28.4 billion over the five-year period (see Table III-7).

TABLE III-7. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSED EXCISE TAX AND FEE INCREASES (By fiscal year, in billions of dollars)

Proposal	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
Extend the Telephone Tax Permanently	1.5	2.6	2.7	2.9	3.1	12.9
Increase Aviation Taxes[a]	1.3	2.3	2.5	2.7	3.0	11.8
Increase the Harbor Maintenance Tax	0.3	0.3	0.4	0.4	0.4	1.8
Accelerate Deposit Deadlines for Telephone Tax Payments	0.1	b	b	b	b	0.2
Switch the Collection Point of Certain Liquor Taxes from Retailers to Wholesalers	b	b	b	b	b	0.2
Impose or Increase Miscellaneous Fees	0.2	0.2	0.4	0.4	0.4	1.5
Total	3.5	5.5	6.0	6.5	7.0	28.4

SOURCES: Congressional Budget Office and Joint Committee on Taxation revenue estimates.

NOTE: Revenues are net of reduced income taxes, except for the revenue effects of accelerated deposits of telephone tax payments.

a. CBO estimates larger revenue gains from this proposal than does the Administration because the CBO baseline includes lower tax rates. Therefore, larger increases are necessary to achieve the Administration's proposed tax rates.

b. Revenue increase of less than $50 million.

Extend the Telephone Tax Permanently. Under current law, local and toll telephone and teletypewriter communication services are subject to a 3 percent tax that is scheduled to expire on January 1, 1991. It has been imposed each year since 1932. Although it has been scheduled to expire every few years since 1959, it has been extended many times. The Administration proposes to make the telephone tax permanent. CBO estimates that permanent extension would garner $1.5 billion in additional revenue in 1991 and a total of $12.9 billion from 1991 through 1995.

Increase Aviation Taxes. The Administration proposes that most Airport and Airway Trust Fund (AATF) taxes be increased by 25 percent over current levels. For example, the passenger ticket tax--the largest aviation tax--would be increased from 8 percent of ticket value to 10 percent. Taxes on aviation fuel and cargo would also be increased. The international departure tax, which was increased from $3 to $6 per departure in the Omnibus Budget Reconciliation Act of 1989, would not be affected by the budget proposal. CBO estimates that, relative to its baseline, this proposal would raise $1.3 billion in 1991 and a total of $11.8 billion over five years. This would provide increased funding for federal aviation programs, which currently require greater spending than is provided by the trust fund.

Airport and airway taxes are scheduled to expire at the end of 1990. Both CBO and the Administration estimate baseline revenues assuming that these taxes will be extended. However, they project the extension at different rates. Recognizing the provision of law ("the trigger") that requires AATF tax rates to be halved on January 1, 1991, if appropriations and obligations fail to total a certain fraction of authorizations, CBO projects AATF taxes at the reduced rates. The Administration projects these taxes at full rates, implying repeal of the trigger provision. Because CBO's baseline includes lower tax rates, a larger increase is necessary to achieve the President's proposed rates. While CBO attributes more revenue gain to this proposal than does the Administration, its projection of total aviation taxes under the President's proposed policy is quite similar to the Administration's.

Increase Harbor Maintenance Tax. Cargo shipped on the nation's waterways is currently subject to a 4 percent ad valorem tax to help defray expenses of dredging and maintaining the nation's harbors. The President's budget proposes to increase the tax rate to 0.125 percent of

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cargo value. The higher rate would yield tax collections large enough to cover the Army Corps of Engineers' harbor maintenance costs. CBO estimates that this would increase revenue by $300 million in 1991 and by $1.8 billion over the budget projection period.

Accelerate Deposit Deadline for Telephone Tax Payments. The Administration would permanently change the rules for deposits of telephone tax payments so that each deposit would be accelerated by approximately one week. This would not change tax liabilities; it would simply speed up the point at which the Treasury records a payment. This change would bring in a little more than $100 million in 1991 and about $0.2 billion over the five years. Because this merely changes the timing of these tax payments, it would not count as deficit reduction, according to the rules of the Balanced Budget Act.

Switch the Collection Point of Certain Liquor Taxes from Retailers to Wholesalers. The President's budget proposes to repeal the existing taxes levied on business operations of liquor retailers, substituting an increase in the existing taxes on liquor wholesalers and manufacturers. The purpose of changing the point in the distribution chain at which the tax is collected is to improve compliance. No tax rates were specified for the increase in the tax on wholesalers and manufacturers, but the increase would be substantial if the proposal is to raise the amount of revenue the Administration estimates. Because it is possible for the Administration to specify a tax rate that would raise sufficient revenue, CBO accepts the Administration's target revenue gain, which is approximately $50 million per year and a total of more than $200 million for the period.

Impose or Increase Miscellaneous Fees. The Administration proposes to establish or change numerous fees, classified as revenues, that CBO estimates would raise about $150 million in 1991 and a cumulative total of $1.5 billion for the 1991 through 1995 period. The proposed changes are: to increase and expand transaction, registration, and filing fees charged by the Securities and Exchange Commission (SEC); to extend permanently the fee, scheduled to expire September 30, 1990, that the Internal Revenue Service charges taxpayers who request letter rulings, opinion letters, or similar determinations; to extend indefinitely mine reclamation fees, scheduled to expire in August 1992, on surface-mined coal, underground coal, and lignite coal; to levy a transactions fee on all "futures" and "options" contracts regulated by

the Commodities Futures Trading Commission; to increase the fees charged by the Army Corps of Engineers for permits to develop or use navigable waterways and wetlands; and to impose fees to cover the costs incurred by the Federal Emergency Management Agency in regulating the evacuation plans of nuclear power plants. Most of these increases are proposed in order to raise funds sufficient to cover some or all of the agencies' costs in providing these services. The SEC fees are, however, an exception. These fees currently are more than sufficient to cover the agency's costs.

The Administration also proposes to reclassify to the outlay side of the budget an Environmental Protection Agency registration fee for all toxins that are not pesticides, and to increase a Department of Housing and Urban Development fee for inspection of real estate developments that are marketed and sold nationally. These two changes would have minor revenue effects.

Internal Revenue Service Initiatives. The President's budget proposes to increase revenues through several initiatives affecting management at the Internal Revenue Service (see Table III-8).

TABLE III-8. CBO ESTIMATES OF THE ADMINISTRATION'S INTERNAL REVENUE SERVICE INITIATIVES
(By fiscal year, in billions of dollars)

Proposal	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
Initiate Management Reforms	0.0	0.0	0.0	0.0	0.0	0.0
Increase Enforcement Funding	0.3	0.5	1.0	1.2	1.2	4.3
Require the IRS to Absorb Half the Cost of the 1991 Pay Raise	-0.1	-0.2	0.0	0.0	0.0	-0.2
Total	0.3	0.4	1.0	1.2	1.2	4.1

SOURCES: Congressional Budget Office and Joint Committee on Taxation revenue estimates.

NOTE: The cost of these initiatives, estimated at approximately $0.9 billion over the 1991-1995 period, is not included in these revenue estimates.

Initiate Management Reforms. The Administration proposes to improve management of IRS enforcement activities sufficiently to raise $2.5 billion in additional revenue in the budget year. Specifically, the IRS has identified five areas in which it believes reallocation of staff and reorientation of programs would yield additional revenue during the projection period.

These initiatives are described as requiring no increase in outlays. Therefore, they require no legislative action or Congressional approval. They are, in effect, a statement that the IRS plans to improve the efficiency of its enforcement activities. Improved management is within the purview of the IRS already, and shifting of resources to increase efficiency and output is part of regular management. The IRS has stated before that its enforcement operations are not designed to maximize revenue yield, and therefore it is feasible that improvements in operations could increase total revenues.

CBO estimates that this initiative will raise no revenue above baseline levels, however, because the IRS has been unable to adequately document how this reallocation would be successfully implemented in the field and how it would raise additional revenue. Past performance provides insufficient evidence of the IRS's ability to reorganize so as to generate such rapid and substantial increases in revenues above baseline levels. Also, recent General Accounting Office studies indicate that IRS enforcement data and estimation methods have been inadequate.

Increase Enforcement Funding. The Administration also requests an increase in funding for the IRS to add to staff and other resources in three areas so as to implement eight new enforcement initiatives. The IRS would increase its examinations, collections, and returns-processing staffs. The new programs would encompass new audits of excise tax and estate and gift tax returns; additional single-issue correspondence and follow-up contact with taxpayers subject to audit; a program to employ retired IRS examiners to train new recruits instead of using current employees as trainers; increased audits of returns claiming very large refunds; increased collection of accounts receivable; investigation of returns of noncustodial parents claiming dependent exemptions; increased document matching of dependents' Social Security numbers to detect excessive claims for dependent exemptions;

and document matching to check returns of low-income homeowners who claim credits for certain mortgage interest.

CBO agrees that these programs could be effective in increasing revenues, but not as rapidly or as substantially as the Administration estimates. Also, the Administration has not projected sufficient funding for years beyond 1991 to support the number of additional personnel it proposes to hire. CBO estimates that these initiatives would raise $0.3 billion in 1991 and $4.3 billion in the 1991-1995 period.

Require the IRS to Absorb Half the Cost of the 1991 Pay Raise. The Administration's budget includes a revenue reduction to reflect the effect on IRS enforcement activities of its proposal that part of the 1991 pay raise for federal employees be absorbed by their employing agencies. The IRS is expected to absorb half the pay raise by not filling attrition vacancies during the year. CBO accepts the Administration's estimate that this staff reduction would reduce revenue by almost $100 million in 1991 and by almost $250 million over the full five years.

Other Revenue Proposals

The President's budget includes several other proposals affecting revenues. All have small revenue effects; some would raise revenue and some would lose revenue. Taken together, CBO estimates that they would raise revenue by $0.5 billion in the budget year, but reduce revenue by $0.5 billion over the five-year period (see Table III-9).

The Administration would make the current credit for child and dependent care expenses refundable and enact a new refundable credit, unrelated to child care expenses, of 14 percent of income or $1,000 per child--whichever is smaller--for each child under age four. Parents could choose the new credit if it was larger than the current credit. Because the primary budget effect of the proposal is to increase refundable outlays in function 500, it is discussed in more detail in Chapter V. The Administration would restore and double the credit for unreimbursed expenses of adopting a child with special needs. It would designate up to 50 enterprise zones over a four-year period, and allow special income tax deductions and credits designed to encourage investment and employment in these zones. It would require property and casualty insurance companies to reduce their loss deductions by

the expected salvage value of loss property that will be sold in the future. It would allow corporations a one-time transfer of assets from overfunded pension plans to be used to pay current retiree health benefits. Finally, it would establish a separate, permanent appropriation account for the Bureau of the Public Debt's full reimbursement of the Federal Reserve System for expenses incurred in managing the

TABLE III-9. CBO ESTIMATES OF THE ADMINISTRATION'S OTHER REVENUE PROPOSALS
(By fiscal year, in billions of dollars)

Proposal	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
Make the Dependent Care Credit Refundable and Establish a Child Care Credit for Children Under Age 4[a]	b	-0.2	-0.2	-0.2	-0.3	-0.9
Double and Restore the Credit for Adoption Expenses	b	b	b	b	b	b
Establish Enterprise Zones	-0.1	-0.2	-0.3	-0.5	-0.8	-1.8
Reduce Loss Deductions of Insurance Companies by Including Salvage Values	0.2	0.2	0.2	0.1	0.1	1.0[c]
Permit Limited Use of Excess Pension Fund Assets to Finance Retiree Health Benefits	0.3	0.5	0.2	0.0	0.0	1.0
Modify Reimbursement to Federal Reserve for Its Debt Management Operations	0.1	0.1	0.1	0.1	0.1	0.3
Total	0.5	0.4	b	-0.5	-0.9	-0.5[c]

SOURCES: Congressional Budget Office and Joint Committee on Taxation revenue estimates.

a. Excludes refundable outlays.

b. Revenue decrease of less than $50 million.

c. Excludes a revenue increase of $0.2 billion in 1990.

government's debt operations, thus preventing a reduction in Federal Reserve net profits (counted in the unified budget as revenues) should future appropriations be insufficient to allow full reimbursement.

CBO REESTIMATES

CBO's estimate of total revenues in 1991 under President Bush's proposed budget is $24 billion less than the Administration's estimate. The difference grows to $39 billion in 1992 and remains around $50 billion each year after that. Most of the difference reflects divergent assumptions about the economy and its effects on underlying baseline, or current services, revenues (see Table III-10).

TABLE III-10. CBO REESTIMATES OF ADMINISTRATION BUDGET REVENUES (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
Revenues as Estimated by the Administration	1,073.5	1,170.2	1,246.4	1,327.6	1,408.6	1,486.3
CBO Reestimates						
Economic						
Baseline	-0.8	-19.0	-35.6	-54.6	-64.1	-62.9
Proposals	0.0	a	-0.1	-0.2	-0.2	-0.2
Subtotal	-0.8	-19.0	-35.7	-54.8	-64.3	-63.1
Technical						
Baseline	-5.2	-0.3	4.5	7.9	16.7	19.9
Proposals	0.2	-4.5	-7.3	-4.4	-4.9	-3.1
Subtotal	-5.0	-4.8	-2.9	3.5	11.8	16.8
Total	-5.8	-23.8	-38.6	-51.3	-52.5	-46.3
Revenues as Estimated by CBO	1,067.7	1,146.4	1,207.8	1,276.3	1,356.2	1,440.0

SOURCES: Office of Management and Budget, *Budget of the United States Government, Fiscal Year 1991* (January 1990); Congressional Budget Office revenue estimates.

NOTE: Revenues include payroll tax receipts of the Old-Age, Surviviors, and Disability Insurance (OASDI) trust funds, which are off-budget.

a. Revenue decrease of less than $50 million.

Economic Reestimates

Revenues depend on the size of the economy--primarily, on personal income and corporate profits and, less importantly, on the volume of transactions. Most of the difference between CBO's and the Administration's budget revenue estimates is directly attributable to assumptions about the economy. CBO forecasts slower economic growth than does the Administration, and higher inflation and interest rates. CBO's estimate of GNP is $109 billion below the Administration's in 1991, and $192 billion below it in 1995. Also, CBO's estimate of total taxable income as a share of GNP is lower than the Administration's. (CBO's higher estimate of the personal income share is more than offset by a substantially lower estimate of the corporate share.) Consequently, CBO's estimate of the personal and corporate tax base is substantially below the Administration's in every year. (The two sets of economic assumptions are compared in more detail in Chapter II.)

Slightly more than half of the downward reestimates are in the corporate income tax and reflect CBO's assumption of lower profits. Most of the remaining reestimates are in personal income and payroll taxes, reflecting CBO's lower estimate of personal income--in particular, lower wages and salaries. Only minor reestimates were made of excise taxes and customs duties. Small upward reestimates were made of Federal Reserve payments because of CBO's higher interest rates.

The economic reestimates are large by recent standards, mostly because of an increase in the individual income tax reestimate. While the Administration's and CBO's growth and inflation assumptions are more alike this year than in the recent past, their projections of personal income have reversed. This year, CBO projects taxable personal income to be $53 billion below the Administration's estimate for 1994. Last year, CBO projected it to be $192 billion above the Administration's estimate for the same year. In addition, last year, the substantially lower inflation assumed by the Administration generated less income tax indexation under Administration assumptions, resulting in higher income tax liability per dollar of personal income and, therefore, a relatively small economic reestimate. This year, the Administration's projection of personal income is higher than CBO's and the economic reestimate is much larger.

The shift in personal income projections reflects the shift in GNP projections. CBO's projection of GNP in 1991 is now $109 billion below the Administration's, whereas last year it was $37 billion below the Administration's projection for 1991. Similarly, CBO's projection of GNP in 1994 is now $204 billion below the Administration's compared with $149 billion above the Administration's last year.

The reestimates are further increased by larger differences in projections of profits. This year, CBO projects economic profits to be $79 billion below the Administration's estimate for 1992 and $112 billion below its estimate for 1994. Last year CBO projected it to be $63 billion below the Administration's estimate for 1992 and a much more modest $66 billion below that for 1994.

Technical Reestimates

Revenue estimation requires technical assumptions about, for example, taxpayer responses to law changes and the timing of tax collections. Technical reestimates reduce the President's estimates of total revenues by $5 billion in 1991 and by $3 billion in 1992 but raise them after that by amounts that grow from $4 billion in 1993 to $17 billion in 1995. This reflects a combination of mostly positive reestimates of baseline receipts and negative reestimates of the receipts from certain policy proposals.

Baseline Reestimates. CBO's technical reestimates, computed using Administration economic assumptions, raise individual income taxes substantially above the Administration's estimates for every year from 1991 through 1995. This is the combined result of many different technical factors in estimation methods. Because these factors interact with one another, the identification of a single causal factor is problematic.

This difference in personal income taxes is partially offset by downward reestimates of corporate income taxes and excise taxes. CBO's reestimates of baseline corporate income taxes are negative: CBO projects a lower effective tax rate on taxable corporate profits. This is a reversal of reestimates in recent years. The Administration has raised its effective rate on profits this year, compared with recent past years.

CBO's reestimates of baseline excise taxes are negative, mainly because of assumptions about aviation taxes. As mentioned above, CBO assumes that these taxes will be extended beyond their expiration date of December 31, 1990, at lower rates than the Administration assumes.

Proposal Reestimates. Reestimates of three of the President's proposals account for most of the technical reestimates.

The Administration estimates that enactment of a 30 percent exclusion of gains realized on capital assets would raise revenue from 1990 through 1995, producing $4.9 billion in additional revenue in 1991 and $12.5 billion over the six-year period. CBO estimates that the exclusion would raise revenue by $3.2 billion in 1991 but would lose revenue each year after that, resulting in a cumulative revenue loss of $11.3 billion over the six-year period. The 30 percent exclusion would significantly lower the effective tax rate on realized capital gains. The Administration assumes that taxpayers would be so responsive to the lower tax rate that they would sell assets with sufficiently large gains (in the aggregate) that taxes paid on the nonexcluded portion would more than offset the effect of the lower tax rate every year. Research by CBO and others indicates that taxpayers are unlikely to be as responsive as the Administration assumes. Although induced realizations would be initially large enough to yield a net revenue gain in 1991, these would not be sustained at high enough levels after that to offset the revenue loss from the lower effective rate. This reestimate is classified as a technical reestimate because it reflects assumptions about taxpayer behavior rather than economic activity.

The Administration estimates that improvement in Internal Revenue Service management would yield additional revenue of $0.1 billion in 1990, $2.5 billion in 1991, and a total of $3.7 billion over the six-year period. For reasons explained earlier in this chapter, CBO estimates that the proposed management improvements would not yield additional revenue above baseline levels. This reestimate is classified as a technical reestimate because it depends on administrative actions only.

The Administration estimates that its proposed 25 percent increase in aviation tax rates above current levels would raise $0.5 bil-

lion in 1991 and $4.1 billion in the period 1991 through 1995. CBO attributes more revenue to this proposal, measured relative to the CBO baseline: $1.3 billion in 1991 and $11.8 billion over five years. This is because the CBO baseline includes lower tax rates, as explained above. This technical reestimate of the President's proposal counteracts the technical reestimate of the baseline mentioned above; the two reestimates, taken together, have little effect on total revenues.

CHAPTER IV

THE ADMINISTRATION'S PROPOSALS FOR DEFENSE AND INTERNATIONAL AFFAIRS

The budgets for defense (function 050) and international affairs (function 150) address complementary national security and foreign policy objectives. This chapter describes each budget in terms of changes in current policies as measured by the CBO baseline and provides a more detailed analysis of major proposals.

The Bush Administration is requesting defense appropriations for 1991 totaling $307 billion, an increase of $5 billion over 1990. Based on CBO estimates, outlays would total about $304 billion, an increase of about $7 billion over 1990. Over five years, the request calls for budget authority totaling $1,584 billion, while outlays would total about $1,564 billion. Despite nominal annual increases, the budget would decline by 2 percent each year in inflation-adjusted dollars, and by 1995 the defense budget would be about 11 percent lower than in 1990.

The budget authority requested for international affairs would rise by $1.8 billion from 1990 to total $20.3 billion in 1991 based on CBO estimates. Outlays would reach $17.8 billion in 1991, an increase of $3.6 billion. Over five years, budget authority would total $102.3 billion, while outlays accumulate to $92.1 billion.

Both budgets reached peaks, in real terms, in 1985 when the defense budget was the highest it has been since the Korean War and the international affairs budget was the highest since the early 1960s. The current budget proposals continue a general downward trend, even though some individual programs would increase substantially. Military personnel and modernization of forces, especially strategic forces, claim high priorities in defense. In the international affairs budget, the increases in funding are concentrated in payments of assessed contributions to international organizations and development and humanitarian assistance.

THE DEFENSE BUDGET COMPARED WITH THE CBO BASELINE

Reductions from the CBO baseline indicate a real cut in funding because the baseline adjusts each category of funding to be constant in real terms. In 1991, all accounts except those for atomic energy defense activities and several other activities receive real cuts in funding. Table IV-1 highlights the Administration's proposed spending changes for defense and their relationship to the CBO baseline.

Funding for weapons procurement would drop sharply in 1991--about 9 percent after adjusting for inflation. The request would lower budget authority by $8 billion below the baseline, in part because a number of programs are terminated. Two of them account for about $2.5 billion of the difference--the Navy's F-14 fighter aircraft ($1.0 billion) and the Army's Apache attack helicopter ($1.5 billion). The Administration also proposes to defer budget authority appropriated for certain programs in 1990 in the hope that as much as $1.4 billion will be used instead to fund procurement of the Air Force's F-15 aircraft and the Army and Marine Corps' M-1 tanks for one more year (see Box IV-1).

Appropriations requested for military personnel are below the baseline for three main reasons. First, the Administration proposes a lower pay raise than was assumed in the baseline--a 3.5 percent pay raise effective in January 1991 compared with CBO's assumed 4.0 percent pay raise effective in October 1990. This difference accounts for $0.5 billion. Second, the Administration would lower active-duty personnel levels by about 37,600 and reserve forces by about 3,400. Lower personnel levels save an additional $0.5 billion from the baseline. Third, the military personnel budget for 1991 appears low because the Administration has requested that more than $1 billion for subsistence-in-kind--food provided through mess halls instead of through military pay--and other activities be shifted into the operation and maintenance (O&M) accounts from the personnel accounts where the funds appeared in 1990 and where they appear in the baseline.

Funding for operation and maintenance and for research, development, test, and evaluation (RDT&E) falls short of baseline levels in

TABLE IV-1. PROPOSED MAJOR SPENDING CHANGES IN THE PRESIDENT'S BUDGET FOR FUNCTION 050, NATIONAL DEFENSE (By fiscal year, in billions of dollars)

	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
			Budget Authority			
CBO Baseline	315.8	328.4	341.6	355.3	369.7	
Proposed Changes						
Military personnel	-2.6	-4.2	-6.0	-8.3	-10.7	-31.8
Operation and maintenance	-0.9	-3.2	-5.7	-8.7	-11.8	-30.3
Procurement	-8.0	-10.4	-13.1	-15.9	-19.0	-66.4
RDT&E	-0.4	-1.3	-2.3	-3.5	-4.8	-12.2
Atomic energy defense	0.9	1.3	1.4	1.4	1.3	6.4
Other defense	2.0	1.8	1.6	1.3	1.0	7.8
Total	-8.9	-15.9	-24.1	-33.7	-44.0	-134.4
President's 1991 Budget	306.9	312.5	317.5	321.6	325.7	
			Outlays			
CBO Baseline	306.9	317.6	328.3	344.8	355.4	
Proposed Changes						
Military personnel	-2.5	-4.1	-5.9	-8.1	-10.6	-31.2
Operation and maintenance	-1.0	-2.8	-5.2	-7.9	-10.9	-27.9
Procurement	-0.7	-3.2	-6.6	-9.8	-13.1	-33.3
RDT&E	-0.3	-0.9	-1.7	-2.8	-4.0	-9.7
Atomic energy defense	0.6	1.3	1.4	1.4	1.3	6.0
Other defense	0.7	1.3	2.0	1.4	1.8	7.2
Total	-3.2	-8.5	-16.0	-25.7	-35.5	-96.0
President's 1991 Budget as Estimated by CBO	303.7	309.2	312.3	319.1	319.9	

SOURCES: Office of Management and Budget; Congressional Budget Office.

NOTE: RDT&E = research, development, test, and evaluation.

BOX IV-1
DEFERRALS AND THE PANAMA SUPPLEMENTAL

In addition to the Administration's customary budgetary proposals, it is also deferring funds appropriated for certain programs in 1990. In a related action, it is asking for supplemental appropriations for aid to Panama and migration and refugee assistance in Eastern Europe and the Soviet Union. The deferrals mean that the Administration has chosen not to make certain funds available for obligation during 1990. The aid to Panama and migration and refugee assistance totals about $570 million in budget authority and $310 million in 1990 outlays and would require appropriation action.

The deferrals affect mostly procurement programs and have two parts totaling $2,194 million. The Administration wants one set of deferrals to be permanent and the funding to be transferred into the appropriation bill for 1991. In other words, it wants the funds--$1,359 million--to be used to buy F-15 aircraft and M-1 tanks in 1991 rather than fast sealift ships, certain munitions, helicopters, weapons modifications, and other programs including some military construction. The second part of the deferrals totals $835 million and is aimed at funds appropriated in 1990 for an icebreaker, funds from 1989 for the V-22 aircraft that the Administration sought to terminate a year ago without clear success, and funds from 1988 and 1989 for ammunition facilities.

All told, the deferrals would save about $294 million in outlays for 1990. This reduction is their connection with the supplemental request for Panama. The Administration links the deferral and supplemental to avoid an increase in the deficit. The costs of aiding Panama are supposed to be balanced by savings from the deferrals. The Administration excluded both the supplemental and the impact of the deferrals on outlays from its budget document, even though the deferrals are in place and the supplemental requires Congressional action. For purposes of the Congressional Budget Act, however, the deferral and supplemental package as submitted is not deficit neutral. It adds to the deficit because only Congressional action on the supplemental is counted or scored; the deferrals--an administrative action--are not scored unless they are part of a bill signed into law.

It is possible that the deferrals will not be in place for the whole year as planned by the Administration. The Congress might choose to overturn them. In addition, there is some question about whether the funds are being withheld inappropriately. If the deferrals have been made for policy reasons rather than for administrative efficiency, the Congressional Budget Act outlines a procedure to require that the funds be made available for obligation. To date, none of the legal steps necessary to release the funds has been taken. However, the General Accounting Office has examined the President's impoundment message and has concluded that $1,251 million of the deferrals are not authorized under the Congressional Budget Act. It is not yet clear whether the Administration will release funds as a result of the statement of the Comptroller General.

1991 for many reasons, including the application of the military personnel pay raise to civilians, as explained above. The shortfall from the baseline in these accounts reflects the net effect of a myriad of program decisions, some of which involve increases and some decreases.

Two areas of the defense budget exceed baseline amounts--atomic energy defense activities and other defense programs, mainly the revolving and management funds. The increase in funding for atomic energy can be traced to programs that would modernize the nuclear weapons complex ($0.5 billion) and to programs that would restore and correct some of the environmental and safety problems that plague the Department of Energy's defense facilities ($0.4 billion). The revolving funds, which provide goods and services related to logistics functions, exceed the baseline because the Administration requests appropriations totaling $2.2 billion to make up for shortfalls in the industrial funds ($0.4 billion), to accumulate war reserve stocks ($0.6 billion), and to purchase certain spare parts for weapons ($1.3 billion). In contrast, the baseline assumes that only $0.2 billion would be included for these accounts based on the amount appropriated in 1990 and an adjustment for inflation.

Outlays in all years are a function of the budget authority for appropriation accounts and their historical spendout rates. Consequently, even though procurement funding in the budget falls below the baseline by much greater amounts than funding for military personnel and operation and maintenance, procurement outlays are closer to the baseline than are outlays in the other two categories. Once funds are appropriated, the Department of Defense (DoD) executes the program--and consequently writes checks--at different rates. For example, for each dollar of procurement funding saved, outlays fall by only 15 cents in the first year compared with 95 cents and 78 cents for each dollar of military personnel and operation and maintenance, respectively.

MAJOR DEFENSE PROPOSALS

The Bush Administration's defense budget for 1991 is only the second budget since 1971 to request a real decline in funding for defense programs. The other budget was the Reagan Administration's 1989 request, which reflected the real decline called for by the two-year budget

agreement reached with the Congress in November 1987. But in that budget the out-years contained real growth. This is not the case for the 1991-1995 proposals in the Bush Administration budget request for 1991.

The defense budget for 1991 through 1995 would continue a trend that began in 1986. The defense budget has fallen by 13 percent in real terms over the 1985-1990 period and would fall by 22 percent over the 1985-1995 period. Nevertheless, real growth from 1980 through 1985 was very rapid, and so the Administration's 1991 budget would still leave de-fense funding 30 percent higher in real terms than it was in 1980; by 1995, it would remain 19 percent higher than in 1980 (see Table IV-2).

TABLE IV-2. REAL CHANGES IN NATIONAL DEFENSE BUDGET AUTHORITY (By fiscal year, in percent)

	Real Change			Real Change Compared with 1980		
	1980-1985	1985-1990	1990-1995	1990	1991	1995
Department of Defense--Military						
Military Personnel	3	1	-9	4	2	-5
Operation and Maintenance	38	-4	-10	32	32	19
Procurement	115	-29	-19	52	38	24
RDT&E	82	-1	-11	80	78	61
Military Construction	97	-21	-9	56	59	42
Family Housing	48	-5	-7	41	45	31
Other DoD--Military	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Weighted Average	52	-14	-11	31	28	16
Other National Defense						
Atomic Energy Defense	93	10	11	113	132	136
Other Agencies	186	-3	11	178	230	207
Weighted Average	97	9	11	116	137	139
Total, National Defense						
Weighted Average	53	-13	-11	33	30	19

SOURCE: Congressional Budget Office.

NOTES: RDT&E = research, development, test, and evaluation; n.a. = not applicable.

The budget totals force the Administration to make certain choices. The Administration states that its priorities within this budget are:

- o Highly qualified and fairly compensated military personnel,
- o Technological superiority,
- o Efficient acquisition of weapons,
- o Maintaining and investing in strategic nuclear forces,
- o Maritime superiority, and
- o Preparedness for mobilization through reserve forces and a responsive industrial base.

The next two sections analyze the request with an emphasis on how these priorities are actually reflected in the budget request.

Force Operations

Funding for force operations reflects some of the Administration's priorities. Specifically, force size and composition show the budget's effect on the quality and compensation of military personnel, the importance of strategic forces, and preparedness for mobilization.

Force Structure. A dramatic easing of East/West tensions is contributing to a changing structure for U.S. forces. The Administration and U.S. allies are negotiating a treaty with the Soviet Union and its allies that would limit conventional forces in Europe (CFE). At the same time, the United States and the Soviet Union are negotiating a strategic arms reduction treaty (START). Perhaps most important, political changes in Eastern Europe have reduced the threat of conventional war. The budget for 1991 supports a force structure that changes more for general purpose (or conventional) forces than strategic forces (see Table IV-3). Strategic forces have a net gain of 48 intercontinental ballistic missiles (ICBMs) based on Trident submarines, but general purpose forces would lose 2 Army divisions, 2 battleships,

and 5 attack submarines. Of the conventional forces, only tactical air forces show a net increase.

The structure of the reserve force changes more subtly. The Navy Reserve would increase by 7 frigates and 55 new aircraft. The Air Force's reserve components decline slightly and receive more up-to-

TABLE IV-3. SUMMARY OF ACTIVE FORCES
(By fiscal year, in numbers)

Category	1989	1990	1991
Strategic Forces			
Land-Based ICBMs	1,000	1,000	1,000
Strategic Bombers	263	244	244
Sea-Launched ICBMs	576	608	656
Strategic Interceptors	36	18	18
General Purpose Forces			
Army Divisions	18	18	16
Marine Corps Divisions	3	3	3
Conventional Bombers	61	33	33
Air Force Tactical Aircraft	1,769	1,743	1,746
Navy Tactical Aircraft	730	698	684
Marine Corps Tactical Aircraft	335	348	383
Naval Forces			
Aircraft carriers	14	14	14
Battleships	4	4	2
Nuclear attack submarines	96	91	86
Other warships	260	244	237
Amphibious assault ships	65	64	66
Airlift and Sealift Forces			
C-5 Aircraft	110	110	110
Other Air Force Aircraft	783	741	735
Ships	69	68	66

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

NOTE: ICBMs = intercontinental ballistic missiles.

date aircraft such as the F-16. The Army's reserve components have no detectable changes, though their equipment will probably be improved. Nevertheless, these seemingly small changes in force structure increase preparedness to mobilize: even though the reserve force structure--measured in terms of units such as divisions--does not increase much absolutely, it does not decline either and consequently rises as a proportion of the total force.

Overall funding for reserve components declines, however, by about 4.5 percent in real terms in 1991. This drop occurs because there are no new starts in reserve military construction and because the separate request for National Guard and Reserve procurement is far below the 1990 level. In recent years, the Congress has tended to add to the Administration's budget request in these areas.

Military Personnel. In cutting the defense budget, the Administration faced a choice between quantity and quality of military personnel. The Administration appears to have opted for the latter since it reduces the number of personnel in 1990 and 1991 by about 41,000 active and reserve people and provides a pay raise of 3.5 percent, which is close to its projected increase of 4.2 percent in the cost of living. That pay raise will cost $1.8 billion in 1991.

Furthermore, funding for recruiting has been maintained so that the most qualified people can still be recruited. Because some of the changes in force structure begin in 1990--mainly the deactivation of two Army divisions--it is useful to look at the change in personnel strength from 1989 through 1991. By that measure, Army active strength declines by 42,000 people compared with 8,000 for the Navy and 41,000 for the Air Force. The Marine Corps is not cut. Personnel levels in the reserve component fall by 19,000. The change in active Army strength is consistent with the loss of two divisions, but reductions in the Air Force and the reserve component go beyond the changes in force structure.

Whether or not a pay raise of 3.5 percent is close enough to the rate of inflation (4.2 percent) projected by the Administration to maintain the current high quality of personnel is uncertain. During the last few years, shortfalls in pay raises from the inflation rate have not hampered these recruiting efforts significantly.

The budget also proposes denying cost-of-living adjustments (COLAs) in 1991 to most retired military personnel and reducing COLAs by one percentage point thereafter. The former proposal affects people who will have retired by the scheduled COLA date, while the latter affects everyone who entered the military before August 1, 1986. (Under current law, people entering after that date have their retirement benefits indexed to the change in the consumer price index less one percentage point.) This proposal would reduce the Defense Department's contribution to the Military Retirement Trust Fund (function 600--income security), where the net budget impact would be felt. Nevertheless, this proposal represents a significant change for members of the armed forces who have based career decisions on fully indexed retirement benefits.

Operation and Maintenance. Operation and maintenance (O&M) funding declines by about 1 percent in real terms. Some of this decline can be traced to reductions in civilian personnel, which would fall by 5,000 from the 1990 level and by 21,000 from the 1989 level. In 1991, the Defense Department would employ 1.1 million civilians.

In January 1990, the Defense Secretary imposed a hiring freeze on civilian personnel positions in the Department of Defense for the remainder of the fiscal year. This action could reduce the DoD civilian work force by more than 40,000 people, or nearly 4 percent, by the end of 1990 if the freeze is not altered or revoked. This freeze could save more than $500 million in defense budget authority in 1990 from what was appropriated, and more than $1 billion in 1991 from what is requested.

The change in O&M funding is difficult to interpret in the aggregate for two reasons. First, the O&M account funds many diverse programs that are hard to summarize. Second, the picture is clouded by several accounting changes. For example, the subsistence-in-kind activities that were funded in 1990 in military personnel are funded in O&M in 1991. Conversely, some other programs, such as certain spare parts, previously funded in O&M are funded in the stock funds this year. Even without accounting changes, most of the net reductions not resulting from civilian personnel cuts seem to come from a wide variety of increases and decreases. One set of important indicators for assessing the contribution of O&M funding to readiness--the operating

tempos for ground forces, pilot training, and ship operations--does not change from 1990 to 1991.

Base Closures. Following Congressional acceptance of the recommendations of the Defense Secretary's Commission on Base Realignment and Closure in 1989, closures or major reductions at more than 40 bases were begun in January 1990. Implementation is expected to take five years and could eventually result in annual operating savings of nearly $500 million. Closures cost money in the near term, however, and the Department of Defense has requested more than $900 million in 1991 for the Defense Base Closure Account, which funds military construction and other one-time costs associated with realignment activities.

In January, after the budget was prepared, the Secretary of Defense released a list of more than 50 additional installations as candidates for closure or realignment. CBO's preliminary estimates suggest that savings in operating costs could eventually amount to $1.5 billion to $2.5 billion each year. As with the closures currently under way, there would be significant near-term costs before these savings would be realized. In addition, the eventual savings would depend on many other factors, including the extent to which force structure is actually reduced.

The lower range of this estimate assumes that personnel reductions would occur at the same proportion of the bases' personnel strength as in the earlier round of closures recommended by the commission. In those actions, military missions performed at affected bases were generally transferred to other bases, and personnel reductions resulted from lower overhead costs and management efficiencies. Using this assumption, carrying out the newly recommended closures would decrease military and civilian end strength by about 40,000. If DoD chooses to discontinue many of the missions currently conducted at these bases, the reduction in personnel requirements would be greater and the annual savings would be nearer to the high end of the estimate.

The estimate also assumes, based on analyses by the General Accounting Office, that savings in operating costs aside from personnel would occur at approximately the same rate as in earlier closures. However, as with the previous closures, the savings in salary associ-

ated with reducing the total number of personnel employed by DoD would be the most significant source of savings, accounting for nearly 80 percent of eventual yearly operating savings.

Force Investment

Funding for force investment consists of procurement and the research, development, test, and evaluation of weapons. By examining the budget request for these accounts, one can see the relatively high priority that the Administration assigns to technological superiority, efficient acquisition, and strategic systems.

Technological Superiority. The defense budget attempts to ensure "technological superiority" of U.S. forces, by emphasizing research and development and by terminating some older programs to fund more advanced systems. Consequently, although "technological superiority" has no obvious definition, one measure of the Administration's emphasis on technological superiority is the change in funding it proposes for the next generation of weapons compared with funding for the current generation; "next generation" refers to weapons still in the research and development stage or the earliest stage of procurement.

Funding for procurement, RDT&E, and some military construction for the next generation of weapons grows by $5 billion, from $49 billion to $54 billion in 1991 (see Table IV-4). Most of this growth stems from just two systems--the SSN-21 nuclear attack submarine, which receives nearly $3 billion more in funding, and the B-2 Stealth bomber, which receives about $1 billion more. Funding for the SSN-21 increases because none was purchased in 1990 and the Administration proposes to buy two in 1991. The B-2 bomber funding grows because DoD bought two aircraft in 1990 and would buy five in 1991, which would bring the total commitment to date for the B-2 to 15 aircraft. The C-17 cargo aircraft increases by $0.3 billion, or 13 percent, to $2.7 billion. Procurement and RDT&E funding for other new weapons rises by $0.8 billion in this budget compared with the CBO baseline.

In contrast, investment in the current generation of weapons falls by nearly $12 billion, or 16 percent, as increases in such systems as the MX missile are more than offset by reductions in programs such as the

TABLE IV-4. INVESTMENT IN THE NEXT GENERATION AND CURRENT GENERATION OF WEAPONS
(In billions of dollars of budget authority)

Category	1991 CBO Baseline	1991 President's Request	Difference Dollars	Difference Percent
Next Generation				
Selected Weapons Systems				
SSN-21 submarine	0.8	3.7	2.9	337
B-2 bomber aircraft	4.5	5.5	1.1	24
C-17 aircraft	2.4	2.7	0.3	13
Other	7.2	7.1	a	b
Other				
Army RDT&E	5.5	5.9	0.3	6
Air Force RDT&E	10.5	10.6	0.1	1
Navy RDT&E	9.2	8.6	-0.6	-7
Other	8.7	9.7	1.0	11
Total	48.8	53.9	5.1	10
Current Generation				
Selected Weapons Systems				
MX missile	1.8	2.8	1.0	58
Apache helicopter	1.7	0.2	-1.5	-90
Mobile subscriber equipment	1.0	a	-1.0	-97
M-1 tank	1.8	0.8	-0.9	-53
F-14 aircraft	1.7	1.1	-0.6	-34
Other				
Air Force aircraft	12.3	8.2	-4.0	-33
Air Force missiles	5.4	6.1	0.7	12
Air Force other procurement	8.7	8.3	-0.3	-4
Navy ships	7.1	4.1	-3.0	-42
Navy aircraft	8.1	8.8	0.7	9
Navy weapons	3.7	3.9	0.2	5
Navy other procurement	8.1	6.1	-2.0	-25
All other procurement	14.4	13.3	-1.1	-8
Total	75.7	63.8	-11.9	-16

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

NOTE: RDT&E = research, development, test, and evaluation.

a. Less than $50 million.

b. Less than 0.5 percent.

Army's AH-64 Apache attack helicopter, a field-telephone system known as mobile subscriber equipment, M-1 Abrams tanks, and the Navy's F-14 fighter aircraft. The Apache program would end with last year's particularly large procurement. The mobile subscriber equipment, the Abrams tank, and the F-14 programs would also come to the end of their acquisition.

The RDT&E budget might also give some indication of the commitment to technological superiority except that funding for it would decline in real terms, though less than the budget as a whole. Within the RDT&E total, the commitment to technological superiority is somewhat ambiguous. The largest real growth occurs in management and support (8 percent), a category in which the technological payoff could be quite small. Other categories of RDT&E funding that support basic scientific research into new technologies increase by 1 percent in real terms. The second stage of research--exploratory development--examines the results of pure research for defense applications; that category decreases in the request by 2 percent in real terms. RDT&E funding for projects in a third stage of advanced development grows by 3 percent, while engineering development, a fourth stage, declines by 7 percent--both in real terms. Finally, development funding to improve weapons already in use increases by 1 percent.

Acquisition Efficiency. The Administration attempts to improve the efficiency of its acquisition process through economical production rates, but the budget shows mixed results for this objective. Of the 17 aircraft programs that claim $16 billion in the 1991 budget, the unit costs of 8 are higher in 1991 than in 1990. Furthermore, although unit costs decline in some of the larger programs such as the B-2 bomber, the reductions may be the natural result of a maturing production line rather than any special emphasis on economic purchases. Even though systems with increases in the annual procurement have declining unit costs, seven aircraft programs with no change in quantity have rising unit costs (see Table IV-5).

Missiles, torpedoes, and other weapons programs reveal changes in unit cost that are more in line with the Administration's goal. Of 26 systems, 19 had unit cost reductions from 1990, while 7 had cost increases. Like the aircraft category, the reasons for the cost changes are

TABLE IV-5. SELECTED PROGRAM CHANGES FOR AIRCRAFT AND MISSILE PROCUREMENT IN THE PRESIDENT'S REQUEST FOR FISCAL YEAR 1991
(In millions of dollars of budget authority)

	1991 Request		Change from 1990	
Weapons System	Quantity	Dollars	Quantity	Unit Cost (Percent)
	Aircraft			
B-2A Aircraft	5	3,828	3	-42
Tanker Transport (TTTS)	28	193	14	-38
MH-60G Helicopter	4	44	0	-27
Civil Air Patrol Aircraft	38	2	0	-27
SH-60B Helicopter	6	168	0	-20
E-2C Aircraft	6	411	2	-16
CH/MH-53E Helicopter	23	460	13	-10
C-17 Aircraft	6	2,146	2	-4
F-16 Aircraft	150	2,903	0	-1
Grisly Hunter Aircraft	1	10	0	2
F/A-18 Aircraft	66	2,123	0	2
C-27A Aircraft	5	91	0	5
AV-8B Aircraft	24	535	0	6
UH-60 Helicopter	72	469	0	16
F-14 Aircraft	12	997	-12	16
F-15 Aircraft	36	1,751	0	32
RC-12 Aircraft	5	87	0	62
	Missiles, Torpedoes, and Other Weapons			
AGM-130 Powered GBU-15	63	38	35	-49
AMRAAM Missile (Navy)	550	423	465	-42
ADATS (LOS-F-H) FAADS	220	272	110	-33
Penguin Missile	65	48	1	-32
Stinger Missile	6,922	252	4,547	-27
Hellfire Missile (Navy)	1,198	43	100	-26
MK-50 ALWT Torpedo	265	334	65	-22
Tomahawk Missile	600	837	200	-20
Trident II Missile	52	1,538	10	-18
AMRAAM Missile (Air Force)	1,250	916	435	-18
MK-48 ADCAP Torpedo	240	356	-20	-16
TOW Missile (Marine Corps)	662	10	85	-15
MX Missile	12	672	0	-11
HAVE NAP Missile	26	28	4	-10
ATACMS Missile	318	187	166	-10
Laser Hellfire Missile (Army)	3,002	123	698	-8
Patriot Missile	817	883	2	-5
Harpoon Missile	215	244	25	-3
HARM Missile (Navy)	1,320	341	158	-1
HARM Missile (Air Force)	120	34	-206	4
RAM Missile	405	71	-175	8
Advanced Cruise Missile	100	489	0	9
PMS Stinger (LOS-R) FAADS	88	123	-34	14
TOW 2 Missile (Army)	13,284	220	3,829	43
Standard Missiles (MR)	900	614	-40	57
MLRS Rocket System	24,000	374	-24,000	60

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

not clear; some programs with increases in production rates have lower unit costs, and the opposite tends to be true for systems with cuts in production rates.

Strategic and General Purpose Forces. Strategic nuclear forces and the Strategic Defense Initiative (SDI) claim a high priority in the 1991 budget derived from what the DoD considers "uniquely important security needs." Accordingly, strategic weapons programs increase by $4 billion, or 25 percent--both in real terms (see Table IV-6). Much of this growth can be traced to the B-2 bomber. Funding for the rail garrison MX missile rises by $1.0 billion, to $2.8 billion in 1991. Also, RDT&E funding for the SDI would increase by more than $0.7 billion, or 20 percent, in real terms over 1990.

In contrast, funding for general purpose weapons declines by $11 billion, or 10 percent. The Army and the Air Force suffer the greatest reductions in procurement of general purpose weapons. The Navy also experiences a reduction of comparable funds but to a much lesser extent, consistent with another of the Administration's priorities--maritime superiority.

Army procurement funding would be one-third lower than in 1990 on an inflation-adjusted basis. Part of this cut (about $1.4 billion) is the result of accounting changes, since certain spare parts would be purchased out of unobligated balances in revolving funds. Still, the Army has reduced its procurement program for aviation, combat vehicle, ammunition, intelligence, and communications systems in anticipation of buying more modern systems later in this decade. This emphasis in the out-years is underscored by the Army's increase in RDT&E--the only overall increase for general purpose programs.

Atomic Energy Defense Activities

Currently, the Department of Energy's (DoE's) nuclear weapons production complex faces severe environmental and operational safety problems. The Administration's request focuses on overhauling this complex and starting a five-year plan for environmental cleanup.

TABLE IV-6. INVESTMENT IN STRATEGIC AND GENERAL PURPOSE WEAPONS (In billions of dollars of budget authority)

Category	1991 CBO Baseline	1991 President's Request	Difference Dollars	Difference Percent
	Strategic			
Selected Weapons Systems				
B-2 bomber aircraft	4.5	5.5	1.1	24
MX missile	1.8	2.8	1.0	58
Strategic Defense Initiative	3.7	4.5	0.7	20
Other procurement	4.3	4.6	0.3	8
Research Development, Test, and Evaluation				
Air Force	1.6	1.9	0.3	21
Army	0.2	0.3	0.1	53
Navy	0.2	0.2	a	5
Other	0.3	0.8	0.4	136
Total	16.5	20.6	4.1	25
	General Purpose			
Procurement				
Army	15.0	10.6	-4.4	-29
Navy	32.6	30.3	-2.2	-7
Air Force	27.6	24.5	-3.1	-11
Other	3.7	3.6	-0.2	-4
Research, Development, Test, and Evaluation				
Army	5.5	5.7	0.3	5
Navy	9.4	8.8	-0.6	-6
Air Force	9.5	9.0	-0.5	-5
Other	4.6	4.5	-0.2	-4
Total	107.9	97.0	-10.9	-10

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. Less than $50 million.

The budget request for these activities is $1.3 billion more than the budget for 1990 and $0.9 billion above the CBO baseline. Over half of this increase is for maintenance and repairs necessary before production of nuclear materials can restart in compliance with safety requirements and environmental laws. The future scope of modernization remains uncertain in light of the changing strategic and environmental priorities facing the aging defense energy complex. The DoE will have a new modernization plan later this year.

Beginning this year, DoE's Environmental Restoration and Waste Management Five-Year Plan consolidates the department's defense and nondefense programs for cleaning up environmental damage from past actions and preventing new damage. Continuing last year's significant increase in cleanup funding, the plan adds $0.5 billion to the CBO baseline in 1991 and $4.5 billion by 1995, 80 percent of which is related to defense activities. However, the plan is subject to many technological and economic variables that may change future spending as the size of the problem becomes clearer.

CBO REESTIMATES OF THE ADMINISTRATION'S REQUEST FOR DEFENSE

In general, CBO and the Administration have a common estimate for outlays in each account in the defense budget. The total annual differences are less than $0.5 billion for 1990 through 1993 but are more than $3 billion for 1994 and $1 billion for 1995. These changes represent certain differences in technical assumptions used for the calculation (see Table IV-7).

The first difference stems from assumptions about pay dates. When the first paycheck of a fiscal year falls on a weekend, current law allows the Department of Defense to issue that paycheck on the previous Friday, pushing it into the previous fiscal year. The first payday of fiscal year 1990 fell on Sunday, October 1, 1989, and checks were issued on Friday, September 29, which was in fiscal year 1989. The first paydays of 1995 and 1996 fall on the weekend. CBO assumed these paydays will be advanced to the previous fiscal year. This assumption affects the timing of outlays but not budget authority. Second, CBO assumed different spendout rates than the Administra-

tion for aircraft procurement for the Air Force based on a different interpretation of the historical data. This is the only account with this kind of difference. Third, the use of a different estimating technique led to differences in 1995 for overall procurement accounts ($1.4 billion) and revolving and management funds ($0.2 billion).

Finally, the deferrals described in Box IV-1 are not reflected in the Administration's estimates, but are included in the CBO reestimate of the request because they represent Administration policy. The Administration is using part of the savings from these deferrals to offset the Panama supplemental (see Box IV-1). However, these deferrals are in effect now.

TABLE IV-7. CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET
(By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	296.3	303.3	309.2	311.9	315.7	318.6
CBO Technical Reestimates						
Military personnel payday advance	0.0	0.0	0.0	0.0	3.6	0.1
Aircraft procurement, Air Force	0.4	0.7	0.1	a	-0.1	-0.2
Overall procurement	a	0.0	0.0	0.0	-0.1	1.4
Revolving and management funds	0.0	0.0	0.0	0.0	0.0	-0.2
Deferrals[b]	-0.3	-0.2	-0.1	0.3	a	0.2
Total	0.1	0.5	a	0.4	3.4	1.3
President's 1991 Budget as Estimated by CBO	296.5	303.7	309.2	312.3	319.1	319.9

SOURCES: Office of Management and Budget; Congressional Budget Office.

a. Less than $50 million.

b. These deferrals were announced with the President's budget but were not reflected in the budget's estimates. Rather, the Administration is claiming the savings from the deferrals as part of the Panama supplemental. However, the legal status of the deferrals is uncertain, and the outlay effects shown here may not occur if the deferrals are withdrawn (see Box IV-1).

THE ADMINISTRATION'S BUDGET REQUEST FOR INTERNATIONAL AFFAIRS

The international affairs function is composed of foreign aid, the conduct of foreign affairs through the State Department and U.S. membership in international organizations, foreign information and exchange activities, and international financial activities, primarily export financing through the Export-Import Bank (Eximbank).

The President's budget follows a well-established pattern of requesting real increases in the budget year and supplementals in the current year, offset by requests for future years that represent a real decline. In 1991, the President requests a large increase for contributions to international organizations and development assistance, and requests decreases in food aid, export financing, and construction of radio facilities.

Foreign Aid

Foreign aid comprises development and humanitarian assistance and security assistance. The latter includes foreign military sales financing and the economic support fund provided for political or national security purposes. The creation of special assistance initiative (SAI) accounts, special regional appropriations, and earmarks that cross accounts has obscured the distinction between development and economic support aid. The President is requesting a modest real increase of $0.2 billion in foreign aid over the next five years, with the increase concentrated in bilateral economic assistance (see Table IV-8).

Bilateral Economic Assistance. Bilateral economic assistance includes development assistance administered by the Agency for International Development and the economic support fund. The President's request represents a continued shift of resources away from functional development accounts to special regional appropriations. The budget's increase for economic assistance appears to be for an SAI for Eastern Europe, but that SAI program is the second year of a three-year initiative authorized last autumn and funded in the economic support fund, which has now been recast in a separate account. The actual increase is for a $175 million Andean drug initiative in the economic support fund, increases for the Philippines, and restoration of economic support

funds to other countries--primarily the American republics, Africa, and Turkey--that were squeezed in 1990 by the funding for Eastern Europe.

Military Assistance. The foreign military sales (FMS) financing program provides credits and grants to enable foreign countries to buy U.S. military equipment and services. The President's request for

TABLE IV-8. PROPOSED MAJOR SPENDING CHANGES IN THE PRESIDENT'S BUDGET FOR FUNCTION 150, INTERNATIONAL AFFAIRS (By fiscal year, outlays in billions of dollars)

	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	16.9	18.0	18.4	18.6	19.6	
Proposed Changes						
Foreign aid						
Bilateral economic assistance	0.2	0.3	0.3	0.3	0.2	1.4
Military assistance	-0.1	-0.1	-0.1	-0.1	-0.2	-0.6
P.L. 480, food aid	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Other	0.0	0.0	-0.1	0.0	-0.1	-0.2
Subtotal	0.1	0.1	0.1	0.1	-0.1	0.2
Conduct of foreign affairs						
International organizations	0.8	0.2	0.2	0.2	0.2	1.7
State Department and other	0.0	0.1	0 .0	0.0	-0.1	-0.1
Subtotal	0.8	0.3	0.2	0.2	0.1	1.6
Foreign information and cultural exchanges	0.0	-0.1	-0.2	-0.2	-0.3	-0.8
Export-Import Bank	0.0	0.0	-0.1	-0.1	-0.1	-0.3
Total	0.9	0.2	0.0	0.0	-0.4	0.7
President's 1991 Budget as Estimated by CBO	17.8	18.2	18.4	18.5	19.2	

SOURCES: Office of Management and Budget; Congressional Budget Office.

25-692 O - 90 - 4

FMS financing for the next five years is slightly below the projected rate of inflation. Financing for Israel and Egypt is frozen at $1.8 billion and $1.3 billion, respectively, with the entire outlay savings in 1991, relative to the baseline, resulting from the nominal freeze for Israel. Since these two countries represent 64 percent of the program, the request offers a real increase of 6 percent in financing for the rest of the world, with the Philippines, Turkey, Portugal, and the American republics receiving the largest increases. The President is again requesting that all FMS assistance be provided as grants. In recent years, only Greece and Turkey have received financing in the form of loans at concessional rates. These two countries would be the beneficiaries of an all-grant program.

Public Law 480, Food Aid. In 1991, the President is requesting $80 million less than was appropriated in 1990, and a cut in new spending authority from $1,522 million to $1,463 million, for the Public Law 480 food aid program. The anticipated drop in commodity costs, especially wheat, would permit an estimated increase in the shipment of commodities from 5.7 million metric tons in 1990 to 5.9 million metric tons in 1991. Shipments in 1992 through 1995 are projected to exceed 6 million metric tons each year. Rather than reflecting a program cut, savings occur relative to the baseline because the Balanced Budget Act requires the use of the GNP deflator instead of a commodity price deflator.

Other Foreign Aid. The President is requesting full funding of scheduled contributions and subscriptions to the multilateral development banks (MDBs) and funding to compensate for past cuts in the scheduled payments, or arrearages. In the aggregate, the 1991 request is a one-time increase over baseline budget authority for the MDBs. This increase is largely offset, however, by a lower request for the contribution to the subsidy account of the International Monetary Fund's enhanced structural adjustment facility. In other programs, the President is requesting a one-time increase for migration and refugee assistance, increases in all years for international narcotics control, and a cut in voluntary contributions to international organizations.

Conduct of Foreign Affairs

The conduct of foreign affairs includes funds for the State Department for carrying out relations with foreign governments. It also includes funds for assessed payments to international organizations of which the United States is a member.

International Organizations and Conferences. The United States pays assessed contributions to international organizations such as the United Nations, and also pays a share of the expenses for international peacekeeping activities in regions such as the Middle East. Since 1986, arrearages have been accumulating for many of these programs because appropriations have fallen short of assessments. The President proposes full funding for payment of arrearages in 1991, and full funding of assessments for the five-year period. These proposals increase spending by $0.8 billion in 1991 and $0.2 billion annually thereafter.

State Department. The President proposes $270 million in 1991 for a new embassy building in Moscow. This request would increase outlays by about $10 million in 1991 and by $270 million over the five-year period. The Administration is requesting a funding increase in 1991 for salaries and expenses, but funding increases in later years do not keep pace with inflation.

Foreign Information and Exchange Activities

In 1990, the Congress appropriated $183 million for the construction of a radio relay station in Israel for the Board for International Broadcasting and the U.S. Information Agency. The savings of $0.8 billion over the five-year period relative to the baseline reflects the completion of this project and the baseline's inclusion of funds for similar projects even though none is currently planned.

Eximbank

The President is requesting a direct loan limit of $500 million for Eximbank, or a real reduction of more than 20 percent. Direct loan obligations would be reduced by $0.8 billion through 1995, resulting in

outlay savings relative to the baseline of $0.3 billion. Appropriations for the bank's tied-aid program would be held at baseline levels for the next two years. The request does not include new funds for the Congressionally initiated interest equalization program.

CBO REESTIMATES OF THE ADMINISTRATION'S REQUEST FOR INTERNATIONAL AFFAIRS

CBO reestimates to the President's request result from both economic and technical estimating assumptions. CBO's assumption of higher interest rates increases the interest income of the Exchange Stabilization Fund by $0.1 billion in 1990 and $1.5 billion over the next six years (see Table IV-9). Technical reestimates are discussed below.

Foreign Military Sales Financing. Disbursements for foreign military sales financing--grants and credits for foreign military sales--have been falling faster than reductions in new appropriations since 1987. This has resulted in the buildup of large undisbursed and uncommitted balances concentrated in programs in a few countries. The Administration's estimate assumes that these balances will be drawn down over the next two years. However, new sales have not yet materialized. Even if the uncommitted balances were applied to new sales of military equipment and services, disbursements for procurement would be spread over at least five years.

International Organizations. Membership in various international organizations, such as the United Nations and its affiliated agencies, entails a treaty obligation to pay an assessed portion of the organization's operating expenses. The assessed payment is due in the organization's fiscal year. The Administration is proposing to pay in full amounts due in calendar year 1990 with the fiscal year 1991 appropriation. While the Administration is asking for an appropriation for arrearages incurred through 1990, in 1991 it proposes to pay only a portion of the amounts due for those earlier years. CBO estimates, however, that any funds appropriated to pay arrearages will be spent in the first year of availability, consistent with historical spendout rates.

Eximbank. The President's request includes a sharp increase in disbursements for direct loans and a deterioration in the collection rate on outstanding loans. The CBO estimate assumes no sharp change from the disbursement and collection experience of the last eight quarters.

State Department. The Administration estimates that 1991 outlays for the Department of State's foreign buildings account will fall below the 1989 level. CBO estimates that spending will be $0.5 billion higher over five years than the Administration estimates for three reasons: the large increase in construction funds the department received in 1990, the requested reprogramming of $65 million in unobligated balances for construction security in 1991, and the change in policy away

TABLE IV-9. CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET FOR FUNCTION 150, INTERNATIONAL AFFAIRS
(By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	14.6	18.2	19.4	18.8	18.9	19.7
CBO Reestimates						
Economic (Exchange Stabilization Fund)	-0.1	-0.2	-0.3	-0.3	-0.3	-0.3
Technical reestimates						
Foreign military sales fund	-0.1	-0.7	-1.0	-0.1	-0.2	-0.2
International organizations	0.0	0.5	-0.1	-0.1	-0.1	-0.1
Export-Import Bank	-0.3	-0.3	-0.2	-0.2	-0.1	-0.1
State Department administration	0.1	0.2	0.2	0.2	0.1	0.0
Other	-0.1	0.0	0.2	0.2	0.2	0.1
Subtotal	-0.3	-0.2	-0.9	0.0	-0.1	-0.2
Total	-0.4	-0.4	-1.2	-0.3	-0.3	-0.5
President's 1991 Budget as Estimated by CBO	14.1	17.8	18.2	18.4	18.5	19.2

SOURCES: Office of Management and Budget; Congressional Budget Office.

from full funding of construction projects. CBO also expects spending for salaries and expenses to be $0.3 billion higher during the same period.

CHAPTER V

THE ADMINISTRATION'S DOMESTIC PROPOSALS

Domestic programs account for most of the deficit reductions in President Bush's proposed 1991 budget. The President's budget, if enacted, would reduce three broad categories of domestic spending--entitlements and other mandatory programs, nondefense discretionary spending, and offsetting receipts--by about $18 billion below baseline levels in 1991. Savings in these three categories would exceed $150 billion over the 1991-1995 period. Additional savings would occur in the other domestic spending category, net interest, as the deficit reductions proposed by the Administration shrink the borrowing needs of the government.

Some domestic programs would fare better than others. The biggest domestic program, Social Security, would change only negligibly, as would many other major benefit programs. But several large entitlement programs--notably Medicare, federal employees' retirement and health benefits, and farm price supports--are targeted for significant reductions by the President. The Administration would change the current mix of discretionary spending, boosting spending in selected areas (chiefly science and space, subsidized housing renewals, and air traffic control) beyond baseline levels but curtailing a host of others. Finally, the President proposes to sell or lease a variety of federal assets and collect new or increased fees from users and beneficiaries of selected government programs.

This chapter summarizes the chief domestic spending proposals in the President's 1991 budget. Programs slated for the biggest changes--whether savings or increases--relative to the baseline are highlighted. The introduction summarizes major proposals within the four broad categories of spending typically used by the Congress and the Administration: entitlements and other mandatory spending (primarily benefit programs), nondefense discretionary programs, offsetting receipts, and net interest. Offering a more detailed perspective, the rest of the chapter shows how the President's proposals would

affect spending in 18 budget functions, each covering specific domestic needs.

ENTITLEMENTS AND OTHER MANDATORY SPENDING

Entitlements and other mandatory spending constitute nearly half of federal outlays and are the fastest-growing category of spending under baseline assumptions. Entitlement and mandatory programs make payments to people, businesses, or other applicants who meet eligibility rules set by law. This category includes most of the benefit programs of the government (notably Social Security, Medicare and Medicaid, unemployment compensation, and others) along with programs such as farm price supports and deposit insurance.

The President's proposals would curtail the growth of this category, with the bulk of the reductions clustered in a handful of major programs (see Table V-1). The fast-growing Medicare program accounts for the biggest proposed savings in 1991, approximately $5 billion; savings would climb to almost $10 billion in 1995. The proposed savings would amount to roughly 5 percent of Medicare benefit outlays in all years. Major proposals include cutting capital reimbursements for hospitals and special payments to teaching hospitals, restricting future increases in payments to hospitals and physicians, and accelerating reforms designed to reduce the government's outlays for overpriced services. The President also proposes to hike the premiums paid by Medicare beneficiaries beyond the levels that would prevail under current law and proposes modest changes in Medicare administrative costs, separate recommendations that are classified as offsetting receipts and discretionary spending, respectively.

Federal employees' retirement is marked for almost $3 billion in savings in 1991 and $6.5 billion in 1995. The Administration urges reducing cost-of-living adjustments to retirees and eliminating the option to take a portion of benefits in a lump sum at retirement. The resulting savings would amount to about 4 percent of total outlays in these programs in 1991 and 8 percent by 1995. Farm price supports (administered by the Commodity Credit Corporation, or CCC) and crop insurance are targeted for $1.5 billion in savings in 1991 and $6.1 billion in 1995; the Administration favors eliminating the crop insurance program, but leaves the CCC savings unspecified.

Federal employees' and annuitants' health benefits are singled out for savings of approximately $2 billion a year in 1991 through 1995. Roughly half of the proposed savings were not specified in the budget, but await submission of the Administration's proposals to reform the Federal Employees Health Benefits program. The remaining savings involve directing the District of Columbia government and the U.S.

TABLE V-1. CBO ESTIMATES OF THE PRESIDENT'S PROPOSALS FOR ENTITLEMENTS AND OTHER MANDATORY SPENDING (By fiscal year, in billions of dollars)

Spending Proposal and Function	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline[a]	648.0	654.5	711.2	751.1	803.6	
Proposed Changes						
Medicare (570)	-5.2	-6.9	-7.8	-8.7	-9.6	-38.3
Federal employees' retirement (600)	-2.7	-4.3	-5.0	-5.7	-6.5	-24.2
Farm price supports and crop insurance (350)	-1.5	-3.7	-5.0	-5.4	-6.1	-21.7
Federal employees' and annuitants' health benefits (550 and 920)	-1.6	-1.7	-1.8	-2.0	-2.1	-9.2
Child nutrition (600)	-0.7	-0.8	-0.9	-1.0	-0.8	-4.2
Child care tax credit (500)	0.2	1.8	2.0	2.1	2.3	8.5
Other	-1.4	-2.7	-2.8	-2.7	-3.1	-12.7
Total	-12.9	-18.3	-21.3	-23.4	-25.9	-101.8
President's 1991 Budget as Estimated by CBO[a]	635.1	636.2	689.9	727.7	777.6	

SOURCE: Congressional Budget Office.

NOTE: Most domestic budget functions contain spending in all three categories--entitlements and other mandatory spending, nondefense discretionary programs, and offsetting receipts. This table summarizes only spending that is classified in the first of these three categories.

a. Includes a small amount of mandatory spending in the international affairs function, discussed in Chapter IV. No changes are proposed.

Postal Service to pay a greater share of their annuitants' health costs--a change that would require the Postal Service to raise postage rates or cut other spending.

The Administration proposes to reform the child nutrition program through enhanced targeting, ending subsidized meals for students with household incomes well above the poverty line (while increasing benefits modestly for some poorer students). Finally, emphasizing the wide variety of formal and informal child care arrangements that parents use, the Administration advocates creating a new, refundable tax credit for low-income working families with children and making the current child and dependent care tax credit refundable. Refundable tax credits result in direct payments to families if the credit exceeds their income tax liabilities. The refundable portions are conventionally treated as budget outlays, just as if they were straightforward transfer programs.

Other proposals affecting entitlement and mandatory programs would reduce spending below baseline levels by $1.4 billion in 1991 and by $13 billion in 1991 through 1995. These budget-cutting initiatives would affect a wide range of programs, including assistance to Puerto Rico, veterans' compensation and pensions, student loans, several social service programs, and activities of the Federal Housing Administration and the power marketing administrations (PMAs).

NONDEFENSE DISCRETIONARY SPENDING

Nondefense discretionary programs encompass a wide variety of federal activities that are controlled through the annual appropriation process. The Congress votes anew each year on funding for these programs. In the baseline, as specified by the Balanced Budget Act, funding levels are assumed to keep pace with inflation, rising by about 4 percent per year. Such increases would maintain today's level of real resources for discretionary programs, but do not provide enough money for new initiatives, including some projects that are in their early stages.

On balance, domestic discretionary programs contribute about $2.1 billion to President Bush's proposed deficit reductions in 1991,

and about $25 billion over the 1991-1995 period (see Table V-2). Within this broad category of spending, the President's budget recommends distinct changes in the allocation of resources.

The first four areas listed in Table V-2 are slated for significant increases in spending, relative to baseline levels. The President proposes above-inflation increases for the space program, listing the space station, manned missions to the moon and Mars, and space-based climate and geophysical research (dubbed the "Mission to Planet Earth") as key priorities. Additional funds for housing assistance are needed primarily to renew the large number of existing contracts that will expire in the next few years. Spending would surpass baseline levels for air transportation under the Administration's proposals to enhance the air traffic control system. And spending for general science and research would exceed baseline levels, with additional funds earmarked for National Science Foundation and Energy Department programs. Other programs (not detailed in Table V-2) that the President has chosen for major spending increases include Internal Revenue Service assistance and enforcement, law enforcement and judicial programs, the Federal Buildings Fund, and Head Start.

Curtailing other nondefense discretionary activities would generate significant deficit reductions. In dollar terms, the biggest reductions would occur in ground transportation, as the Administration proposes to end subsidies to Amtrak and cut spending for highways and mass transit. Restricting loans made by the Rural Electrification Administration (REA) and the Farmers Home Administration (FmHA) would yield considerable savings. For both REA and FmHA, as well as for lending programs of the Small Business Administration (SBA), the President proposes to shift from direct federal loans to private financing with partial federal guarantees. Under current budget accounting, such a shift reduces the deficit, because the budget counts direct loans as outlays but defers recognition of defaults on guaranteed loans (while recording receipts from guarantee fees at the outset). But even though standard accounting practices exaggerate the savings, the President's proposal would reduce the subsidies afforded to borrowers and would limit the government's overall exposure.

TABLE V-2. CBO ESTIMATES OF THE PRESIDENT'S PROPOSALS FOR NONDEFENSE DISCRETIONARY SPENDING
(By fiscal year, in billions of dollars)

Spending Proposal and Function	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline						
Domestic functions	201.9	210.3	217.6	225.5	233.1	
International affairs[a]	18.0	19.1	19.6	19.9	20.7	
Total	219.9	229.4	237.1	245.4	253.8	
Proposed Domestic Changes						
Space (250)	1.3	3.2	4.6	5.4	5.8	20.3
Housing assistance (600)	0.2	1.2	2.1	2.9	3.7	10.2
Air transportation (400)	0.1	0.6	1.1	1.4	1.6	4.9
General science and research (250)	0.2	0.6	0.8	1.1	1.2	3.9
Amtrak, mass transit, and other ground transportation (400)	-1.3	-2.5	-3.5	-4.3	-5.1	-16.6
Rural Electrification and Farmers Home Administration programs (various)	-1.3	-2.0	-2.6	-3.2	-3.7	-12.7
Census (370)	-0.9	-1.2	-1.3	-1.5	-1.5	-6.4
Disaster relief and insurance (450)	-0.6	-1.1	-1.4	-1.5	-1.5	-6.0
Other	0.1	-0.8	-3.8	-7.0	-10.7	-22.3
Subtotal	-2.1	-2.0	-4.0	-6.5	-10.3	-24.8
International affairs (150)[a]	0.9	0.2	b	b	-0.4	0.7
Total	-1.2	-1.8	-3.9	-6.5	-10.7	-24.1
President's 1991 Budget as Estimated by CBO						
Domestic functions	199.8	208.3	213.6	219.0	222.8	
International affairs[a]	18.9	19.3	19.6	19.9	20.3	
Total	218.7	227.6	233.2	238.9	243.1	

SOURCE: Congressional Budget Office.

NOTE: Most domestic budget functions contain spending in all three categories--entitlements and other mandatory spending, nondefense discretionary programs, and offsetting receipts. This table summarizes only spending that is classified in the second of these three categories.

a. The President's proposals for international affairs spending were discussed in Chapter IV.

b. Less than $50 million.

Two categories that feature large spending reductions--census activities and disaster relief and insurance--illustrate an anomaly of baseline projections. Because of the decennial census and two recent natural disasters (Hurricane Hugo and California's Loma Prieta earthquake), both programs will generate large outlays in 1990; the Administration's budget envisions a return to more normal spending levels, well below 1990's level adjusted for inflation. Other discretionary activities that are targeted for major spending reductions include education and training, community and regional development, agriculture, health research and delivery of health care services, and low income energy assistance.

Nondefense discretionary programs are controlled through the appropriation process, in which the Congress sets budget authority or

TABLE V-3. NONDEFENSE DISCRETIONARY SPENDING, FISCAL YEAR 1991 (In billions of dollars)

Committee and Subcommittee	CBO Baseline		President's Budget as Estimated by CBO		Difference	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
Appropriations Committee						
Commerce, Justice, State	19.6	18.6	18.8	19.0	-0.8	0.4
District of Columbia	0.6	0.6	0.5	0.5	a	a
Energy and Water	9.2	9.1	9.1	9.0	-0.1	-0.1
Foreign Operations	14.7	12.6	14.9	12.8	0.2	0.2
Interior	12.3	11.6	10.7	11.2	-1.7	-0.4
Labor, Health and Human Services, Education	46.4	52.4	46.8	52.3	0.4	-0.1
Legislative Branch	2.1	2.0	2.3	2.2	0.2	0.2
Rural Development, Agriculture	9.5	9.4	7.2	7.7	-2.3	-1.7
Transportation	13.3	28.9	11.4	27.9	-1.9	-1.0
Treasury, Postal Service	10.3	10.2	9.9	10.1	-0.4	-0.1
Veterans, Housing and Urban Development, Independent Agencies	51.8	57.7	59.2	59.3	7.4	1.6
Subtotal	189.7	213.1	190.7	212.0	1.0	-1.1
Other Committees	20.1	6.8	20.2	6.7	0.1	-0.1
Total	209.8	219.9	210.9	218.7	1.1	-1.2

SOURCE: Congressional Budget Office.

a. Less than $50 million.

other limitations on agencies' ability to commit funds, thereby influencing actual outlays. The Congress focuses on 13 regular appropriation bills, two of them dealing exclusively with the defense budget. Table V-3 shows the implications of the President's proposals for the remaining 11 nondefense bills. One subcommittee would mete out substantially greater budget authority, compared with the baseline, if the President's proposals for fiscal year 1991 are enacted: the Veterans, Housing and Urban Development, and Independent Agencies subcommittee has jurisdiction over both subsidized housing and the space program--two programs targeted for substantial increases by the President. Major reductions in budget authority would face the Subcommittees on Commerce, Justice, and State (with jurisdiction over the census), Interior (responsible for many energy and natural resource programs), Rural Development and Agriculture, and Transportation.

OFFSETTING RECEIPTS

Offsetting receipts are recorded in the budget as negative outlays, rather than as revenues. Most are intrabudgetary or are collected by the government in the course of voluntary, business-type transactions. President Bush's proposed 1991 budget would increase offsetting receipts--thereby reducing the deficit--by $2.9 billion in 1991, and by an average of $5 billion a year in the 1991-1995 period. Key proposals are shown in Table V-4.

The Administration proposes to sell or lease a variety of federal assets. The Reagan and Bush Administrations have been rebuffed in previous years' budgets when they advocated selling the naval petroleum reserves; now, the Administration recommends leasing the reserves. Like an outright sale, this proposal would reduce the deficit immediately (by an estimated $1 billion in 1991), but lease and royalty income in subsequent years would not quite offset the loss of income from continued production under government ownership. The Administration proposes to sell selected power marketing administrations (PMAs), namely Alaska and part of Southeastern; CBO estimates that significant proceeds would not occur until 1992. Auctioning a portion of the unassigned electromagnetic spectrum would earn an estimated $0.4 billion in both 1991 and 1992 for the Federal Communications

TABLE V-4. CBO ESTIMATES OF THE PRESIDENT'S PROPOSALS FOR OFFSETTING RECEIPTS
(By fiscal year, in billions of dollars)

Spending Proposal and Function	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline[a]	-60.4	-63.4	-66.0	-69.3	-72.8	
Proposed Changes						
Naval petroleum reserves leasing (950 and 270)[b]	-1.0	0.3	0.3	0.6	0.6	0.7
Sale of power marketing administrations (950 and 270)[b]	-0.1	-1.2	0.1	0.1	0.1	-1.0
Federal Communications Commission auctions (950)	-0.4	-0.4	0	0	0	-0.8
Arctic National Wildlife Refuge (950)	0	0	-1.6	c	-0.9	-2.5
Unspecified asset sales (950)	0	-1.6	-1.6	-1.6	-1.6	-6.4
Medicare premiums (570)	0	-0.5	-1.7	-3.0	-4.5	-9.7
Customs user fees (750)	-0.7	-0.8	-0.8	-0.8	-0.8	-3.7
Government-sponsored enterprise fees (800)	-0.1	-0.3	-0.7	-0.9	-1.1	-3.0
Other domestic	-0.7	0.2	0.2	0	0.4	0.1
Total	-2.9	-4.3	-5.8	-5.5	-7.9	-26.4
President's 1991 Budget as Estimated by CBO[a]	-63.2	-67.8	-71.7	-74.9	-80.7	

SOURCE: Congressional Budget Office.

NOTE: Most domestic budget functions contain spending in all three categories--entitlements and other mandatory spending, nondefense discretionary programs, and offsetting receipts. This table summarizes only spending that is classified in the third of these three categories.

a. Includes offsetting receipts in the international affairs function, discussed in Chapter IV. No changes are proposed.

b. Further savings of several hundred million dollars a year would be realized in the costs of administering the naval petroleum reserves and the power marketing administrations. These savings are classified as discretionary.

c. Less than $50 million.

Commission. Opening the Arctic National Wildlife Refuge to oil and gas exploration and development would generate an estimated $1.6 billion in 1993 and another $900 million in 1995. Unspecified asset sales are targeted to yield $1.6 billion a year in 1992 through 1995.

The Administration proposes to increase Medicare premiums beginning in 1992 beyond the levels that would prevail under current law, yielding an extra $0.5 billion in 1992 and an extra $4.5 billion in 1995. Increases in these premiums, under current law, cannot exceed the rate of inflation, and thereby fail to keep up with costs in the fast-growing Supplementary Medical Insurance (SMI) program for which they are earmarked. The Administration's proposal would keep total collections from premiums at about 25 percent of SMI program costs. The President's budget proposes to extend certain user fees that finance the processing of passengers and merchandise by the Customs Service, otherwise slated to expire later this year. Fees would be collected from government-sponsored enterprises, such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), whose securities enjoy special standing in the credit markets even though they do not bear the full faith and credit of the government. The Administration also proposes to charge a variety of increased user fees for Coast Guard services, recreational resources, and licensing and inspection.

NET INTEREST

Net interest spending is not controlled directly, but reflects the impact of other spending and revenue decisions made by policymakers. The Administration's budget proposals, if fully enacted, would reduce federal government deficits and borrowing needs significantly below baseline levels. Large savings in interest costs would result. As shown in Table V-5, adopting the Administration's proposals would reduce net interest costs by $1.1 billion below the baseline in 1991, and by $17 billion in 1995. Federal debt held by the public at the end of 1995 would reach about $2.7 trillion--higher than today's figure, but nearly $300 billion below the level that would be reached in the absence of policy changes. And the ratio of federal debt to GNP, which falls gradually even in the baseline, would drop more sharply under the President's proposed policies: from 43 percent at present to 36 percent by 1995.

TABLE V-5. CBO ESTIMATES OF THE PRESIDENT'S PROPOSALS FOR FEDERAL DEBT AND NET INTEREST COSTS (By fiscal year)

	1990	1991	1992	1993	1994	1995
Net Interest Outlays (In billions of dollars)						
CBO Baseline	178.8	184.0	190.1	198.2	204.1	208.2
Proposed Changes	a	-1.1	-3.7	-6.9	-11.3	-17.0
President's 1991 Budget as Estimated by CBO	178.7	182.9	186.5	191.3	192.8	191.2
Federal Debt Held by the Public (In billions of dollars)						
CBO Baseline	2,344	2,504	2,627	2,758	2,878	2,988
President's 1991 Budget as Estimated by CBO	2,343	2,472	2,555	2,633	2,678	2,689
Federal Debt Held by the Public (As a percentage of GNP)						
CBO Baseline	43.0	43.2	42.5	41.9	41.1	40.0
President's 1991 Budget as Estimated by CBO	43.0	42.6	41.3	40.0	38.2	36.0

SOURCE: Congressional Budget Office.

a. Less than $50 million.

THE PRESIDENT'S DOMESTIC PROPOSALS BY FUNCTION

The remainder of this chapter presents detailed descriptions of the President's proposals as they affect 18 budget functions, covering the entire domestic budget. Budget functions summarize federal spending that addresses a specific national need. Most functions include all three types of spending--entitlements, discretionary spending, and offsetting receipts--discussed above. The analyses feature additional

details about the savings or increases in spending compared with the CBO baseline, and summarize the key estimating differences--stemming from contrasting economic assumptions or from other, technical factors--between the CBO and the Administration's Office of Management and Budget (OMB) projections.

FUNCTION 250: GENERAL SCIENCE, SPACE, AND TECHNOLOGY

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	15.2	15.7	16.1	16.8	17.5	
Proposed Changes						
National Aeronautics and Space Administration						
Space station	0.4	1.0	1.3	1.2	0.8	4.6
Space shuttle	0.6	0.9	1.0	1.0	1.2	4.7
Space science	0.4	1.1	2.1	3.0	3.8	10.4
Other NASA	a	a	0.1	0.1	a	0.2
National Science Foundation	0.1	0.3	0.5	0.7	0.9	2.5
Department of Energy						
Superconducting super collider	0.1	0.2	0.3	0.2	0.3	1.1
Other general science research	a	0.1	0.1	0.1	0.1	0.3
Total	1.5	3.6	5.3	6.3	6.9	23.7
President's 1991 Budget as Estimated by CBO	16.7	19.3	21.4	23.2	24.4	
President's 1991 Budget	16.6	19.4	21.4	22.9	24.0	
CBO Reestimates	0.1	a	a	0.2	0.4	

a. Less than $50 million.

Proposed Policy Changes

In conjunction with the President's theme of "Investing in the Future," programs in function 250 are slated for major increases in the 1991 budget. Beginning with a 22 percent increase in budget authority for 1991 (over the 1990 level), spending would be 29 percent above the baseline for the 1991-1995 period. This increase would be distributed among all the agencies in the function. Outlays for the National Aeronautics and Space Administration (NASA) would increase by 31 percent over the baseline; Department of Energy (DOE) general science

programs would rise by 23 percent; and the National Science Foundation (NSF) would get a 21 percent increase. For all of these major spending proposals, the 1991 level would be only a down payment on future spending requirements; the budget includes further spending increases in later years to carry out these proposals.

Much of the increased spending would go toward completing two major science projects--the space station and the superconducting super collider (SSC). Both projects are targeted for funding at levels significantly above the CBO baseline. The President's budget includes a three-year advance appropriation request for the space station: \$2.5 billion for 1991, \$2.9 billion for 1992, and \$3.0 billion for 1993, compared with \$1.7 billion in 1990. NASA's request also includes \$4.7 billion in spending above the baseline for the shuttle program, mostly for an increase in shuttle flights but also for shuttle modifications needed to support construction of the space station. For the SSC, the President is seeking \$312 million for 1991, \$559 million for 1992, and \$503 million for 1993, compared with \$219 million for 1990. Spending for the remainder of the DOE general science budget would increase at a slightly faster rate than the baseline.

Two main features of this budget--NASA's human exploration initiative and the Mission to Planet Earth--are at the beginning of their funding cycle. The human exploration initiative includes plans for a lunar base and a mission to Mars. The Mission to Planet Earth, which features the launch of Earth-observing satellites, would be a centerpiece of the Administration's Global Change Research Program. Total funding requested for these programs for 1991 is around \$450 million. Their funding is scheduled to increase quickly, however, and the President proposes to spend roughly \$10 billion on them through 1995.

The President is also proposing to continue increasing the size of the NSF budget. For 1991, the NSF appropriation would increase by \$300 million above the 1990 level of \$2.1 billion. Increases would continue in subsequent years, with the agency's appropriation rising to \$3.5 billion in 1995. Spending over this period would be \$2.5 billion above the baseline. All major parts of the NSF budget--research and related activities, science and engineering education, and the Antarctic program--would receive increased funding.

CBO Reestimates

CBO estimates for outlays are very close to the Administration's figures in most years, but are slightly higher for space science research and development in 1994 and 1995.

FUNCTION 270: ENERGY

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	4.5	4.4	5.1	5.5	5.2	
Proposed Changes						
Power marketing reforms	0	-1.0	-0.9	-0.9	-0.8	-3.5
Rural electrification	-0.1	-0.3	-0.6	-0.9	-1.1	-3.0
Nuclear regulation fees	-0.3	-0.3	-0.3	-0.3	-0.4	-1.7
Fossil energy research and development	-0.1	-0.2	-0.2	-0.3	-0.3	-1.1
Conservation	-0.1	-0.2	-0.2	-0.3	-0.3	-1.0
Strategic Petroleum Reserve	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Sale of power marketing administrations[a]	0	b	0.1	0.1	0.1	0.3
Lease of naval petroleum reserves[a]	0	0.6	0.5	0.5	0.4	1.9
Energy supply research and environmental restoration	0.1	0.2	0.2	0.3	0.1	1.0
Other	-0.1	b	b	b	-0.3	-0.4
Total	-0.6	-1.3	-1.5	-1.9	-2.6	-7.8
President's 1991 Budget as Estimated by CBO	3.9	3.1	3.7	3.6	2.6	
President's 1991 Budget	3.0	3.1	3.2	3.0	2.6	
CBO Reestimates	0.9	b	0.5	0.6	b	

a. The receipts from the proposed lease of the naval petroleum reserves and the proposed sale of the Alaska and portions of the Southeastern power marketing administrations are shown in function 950. Outlays in function 270 would increase, relative to the baseline, after these proposed asset transactions, because the assets would no longer generate direct receipts to the government.

b. Less than $50 million.

Proposed Policy Changes

The President proposes to increase receipts and cut spending in energy programs, which together would reduce net outlays in function 270 by 12 percent below the baseline in 1991. The effect of these proposals

accelerates over time, reducing outlays by 50 percent below the baseline in 1995. Outlay savings would total $0.6 billion in 1991 and $7.8 billion over the 1991-1995 period. These savings are net of losses in receipts that would result from the proposed sale of the Alaska Power Marketing Administration (PMA) and part of the Southeastern PMA, and from the proposed lease of the naval petroleum reserves (NPRs). Excluding the outlay effects of these asset transactions, outlay savings would total about $10.0 billion from 1991 through 1995. Most of the proposed spending reductions are similar or identical to ones that have been included in previous budgets.

Power Marketing Repayment Reforms. The President is seeking to raise interest rates and speed up principal repayments to the Treasury made by PMAs. These reforms would increase the price of federally generated hydropower, and would increase offsetting receipts by $3.5 billion over the 1991-1995 period, assuming the policy can by fully implemented in 1992.

Rural Electrification. The President proposes to eliminate most direct federal loans to rural electric and telephone cooperatives after 1990, and to discontinue appropriations to the revolving fund that administers such loans. The proposed 1991 loan level is almost 90 percent below the baseline total of $1.8 billion. These direct loans would be replaced with partial federal guarantees of privately financed loans. Borrowers would pay a fee on the guaranteed portion of new private loans. These proposals would save an estimated $3.0 billion over the 1991-1995 period.

Nuclear Regulatory Commission Fees. The President proposes to increase fees charged by the Nuclear Regulatory Commission (NRC) to nuclear utilities so that they would cover 100 percent of the agency's budget, excluding any amounts appropriated to NRC from the nuclear waste fund. Under current law, NRC is required to charge fees covering 33 percent of its budget in 1991. Over the five-year period, the proposal to raise fees would increase receipts by $1.7 billion.

Fossil Energy Research and Development. The President's appropriation request for fossil energy in 1991 is 53 percent below the baseline level. Under the proposed budget, federal spending for fossil energy research and development would be reduced by $1.1 billion, or 46 per-

cent, over the 1991-1995 period. Nearly all of the proposed reduction is in funding for research on the use of coal.

Conservation. The appropriations requested for energy conservation in 1991 represent a reduction of 50 percent relative to the baseline. Over five years, conservation spending in the budget is $1.0 billion, or 46 percent, below baseline levels. About $0.7 billion of this reduction would result from cuts in grants to states for energy conservation programs, with the remainder from reductions in conservation research and development activities.

Strategic Petroleum Reserve. The President proposes to fill the Strategic Petroleum Reserve (SPR) at rates varying between 50,000 and 60,000 barrels per day over the 1991-1995 period. Ten million barrels would be set aside as a defense petroleum inventory, if the Administration's proposal to sell lease rights to the NPRs is also adopted. CBO estimates that the budget plan would yield a total of about 685 million barrels in the SPR by the end of fiscal year 1995. By comparison, the baseline would allow for fill rates between 60,000 and 70,000 barrels per day over the next five years, for a total of about 710 million barrels at the end of 1995. As of January 1, 1990, the SPR contained 580 million barrels. The President's budget for the SPR would result in five-year savings of $0.5 billion, relative to the baseline.

Power Marketing Administrations and Naval Petroleum Reserves. Income from the sale of the Alaska PMA and part of the Southeastern PMA and from leasing the NPRs appears in budget function 950 and is estimated to total $3.3 billion over the 1991-1995 period. These savings would be partially offset, however, by an increase in outlays in function 270, because the government would no longer be collecting receipts from selling oil or electricity produced by these assets. (For NPR leasing, the government would receive annual royalty payments, included in function 950). In 1992, the proposed asset sales would result in a loss of receipts of $0.6 billion, with similar losses in subsequent years. Over the five-year period, net outlays in function 270 would increase, relative to the baseline, by $1.9 billion from the sale of NPR lease rights, and by $0.3 billion from the sale of the PMAs.

Energy Supply Research and Environmental Restoration. The President's proposals for energy supply research and environmental restoration activities would increase outlays by $1.0 billion over five years

from baseline levels. Most of the proposed increase is for waste cleanup and other environmental work. The environmental restoration request of $429 million for 1991 is about 65 percent higher than the 1990 level. The President also proposes a 30 percent one-year increase, to $116 million in 1991, in funding for solar and other renewable energy sources.

Other. The budget also includes proposals to establish a government-owned uranium enrichment corporation and to provide no additional funding for the clean coal program beyond what has already been appropriated. CBO estimates that these proposals would lower outlays by about $0.4 billion below the baseline for the 1991-1995 period.

CBO Reestimates

CBO's estimates of net outlays for function 270 under the President's budget proposals are above the Administration's estimates by $0.9 billion in 1991. The largest estimating difference involves PMA repayment reform. The budget assumes that PMA rates could be increased in time to collect an additional $1.0 billion in power receipts for 1991. CBO estimates that such a large electric rate increase would require more time to implement, and that additional receipts could not be collected until 1992. Most of the remaining CBO reestimates are for rural electrification loans; CBO expects higher outlays for approved but unadvanced loans than are estimated in the President's budget, particularly in 1993 and 1994.

FUNCTION 300: NATURAL RESOURCES AND THE ENVIRONMENT

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	18.7	19.3	19.9	20.3	20.7	
Proposed Changes						
Water resources	a	-0.1	-0.4	-0.5	-0.8	-1.8
Conservation, land management, and recreational resources	a	-0.2	-0.3	-0.5	-0.7	-1.7
Pollution control and abatement	0.1	0.1	-0.1	-0.5	-0.9	-1.3
Other natural resources	a	a	-0.1	-0.1	-0.4	-0.6
Total	a	-0.3	-0.9	-1.6	-2.7	-5.5
President's 1991 Budget as Estimated by CBO	18.7	19.1	19.0	18.7	18.0	
President's 1991 Budget	18.2	18.9	18.4	18.3	17.8	
CBO Reestimates	0.6	0.1	0.6	0.3	0.2	

a. Less than $50 million.

Proposed Policy Changes

The President's budget for natural resources and the environment would result in estimated outlays of $18.7 billion in 1991, the same as the CBO baseline. Over the 1991-1995 period, however, the President's proposals would result in outlay savings relative to the baseline totaling $5.5 billion, a reduction of about 6 percent. Spending in most program areas would be held below baseline levels over the five-year period.

Water Resources. The President's budget would result in outlays for water resources programs that are below the baseline by $1.8 billion through 1995. Most of these savings would result from reductions in water development construction programs, with the largest reduction in activities of the Bureau of Reclamation ($1.2 billion).

The total proposed budget authority of $4.3 billion for water resource activities in 1991 is about 2 percent ($80 million) below baseline levels, resulting in first-year outlay savings of $18 million. This amount reflects decreases from baseline levels of 10 percent ($95 million) for the Bureau of Reclamation's water development program and 21 percent ($44 million) for the water conservation activities carried out by the Soil Conservation Service. Funding requested for the Army Corps of Engineers' water resource development activities would be 2 percent ($57 million) above the baseline.

Conservation, Land Management, and Recreational Resources. Proposed funding for conservation, land management, and recreational activities totals $5.9 billion in 1991, 4 percent below the baseline projection of $6.2 billion. Major activities in this area would remain below the baseline through 1995, with the exception of a new tree-planting program to be administered by the Forest Service. Total outlays would be below the baseline by $31 million in 1991 and by $1.7 billion over the five-year period.

As part of the America the Beautiful Initiative, the President has requested budget authority of $175 million a year for a new program to finance technical assistance and cost-sharing for tree planting by private landowners and local communities. Additional spending would be $131 million in 1991 and $0.8 billion over the 1991-1995 period.

The recreational land acquisition and construction activities to be carried out by the Departments of Agriculture and the Interior are slated for reductions relative to the baseline. The proposed appropriations of about $390 million a year would be $249 million below the baseline in 1991 and would reduce outlays by about $50 million in 1991 and $1.0 billion over the five-year period.

The President's proposals for other activities carried out by the Forest Service, including the timber sales program and road construction activities, would also result in outlay savings relative to the baseline of $59 million in 1991 and $0.8 billion through 1995. Similarly, other activities of the Bureau of Land Management would remain below baseline levels in all years, with outlay savings of $68 million in 1991 and $0.6 billion over the five-year period.

Pollution Control and Abatement. The budget for environmental programs would result in outlays that are $1.3 billion below the baseline over the 1991-1995 period. By 1995, outlays would be about $0.9 billion, or 14 percent, below the baseline. The proposed phaseout of the wastewater treatment construction grants program would produce most of these savings--$1.7 billion over five years. Appropriations would drop from $1.9 billion in 1990 to $1.6 billion in 1991 and to zero in 1995. In addition, proposed fees for certain environmental services would result in five-year outlay savings of nearly $0.2 billion. The spending reductions would be partially offset by requested increases in other programs. The President's budget includes spending for the Superfund program that would be $0.4 billion above the CBO baseline during the five-year period. Outlays for the Environmental Protection Agency's (EPA's) operating programs would also exceed the baseline by $0.1 billion through 1995; proposed 1991 appropriations would be $149 million above the baseline. Much of the increase is to implement proposed revisions to the Clean Air Act.

Other Natural Resources. The President's proposals for other natural resources would lower spending by $0.6 billion relative to the CBO baseline through 1995. The majority of these spending reductions--$0.5 billion over five years--come from the operations, research, and facilities of the National Oceanic and Atmospheric Administration. The Administration also proposes to sell all assets of the Bureau of Mine's helium operations, which would raise $12 million in 1991.

CBO Reestimates

The major estimating differences involve spending for emergency fire fighting and EPA wastewater treatment construction grants. CBO's estimate of emergency fire-fighting costs incurred by the Departments of Agriculture and the Interior, which is based on a five-year historical average, is approximately $1 billion higher than the President's over the 1991-1995 period. CBO also estimates that the pace of outlays for the construction grants program will quicken as a consequence of recent changes, resulting in spending that is $0.6 billion above the amounts anticipated in the President's budget over the five years.

FUNCTION 350: AGRICULTURE

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	16.3	17.4	16.0	15.5	14.7	
Proposed Changes						
Commodity Credit Corporation	-1.4	-3.1	-4.4	-4.8	-5.5	-19.3
Crop insurance	-0.2	-0.7	-0.8	-0.8	-0.9	-3.4
Agricultural Credit Insurance Fund	-0.5	-0.6	-0.6	-0.6	-0.7	-2.9
Temporary emergency food assistance	0.1	0.1	0.1	0.1	0.1	0.6
Other	-0.1	-0.1	-0.2	-0.2	-0.2	-0.8
Total	-2.1	-4.4	-5.9	-6.4	-7.1	-25.9
President's 1991 Budget as Estimated by CBO	14.3	13.0	10.1	9.2	7.5	

Proposed Policy Changes

The Administration proposes to reduce spending on agriculture by making unspecified cuts in farm commodity programs, by eliminating the federal crop insurance program, by reducing direct loans to farmers provided through the Farmers Home Administration, and by increasing user fees for the services provided by the Department of Agriculture (USDA). The budget also reduces funding for the Extension Service and for a number of other USDA activities, continues funding for emergency food assistance that would otherwise expire, and increases funding for agricultural research. CBO estimates that these proposals would reduce outlays by $2.1 billion in 1991 and by $25.9 billion over the 1991-1995 period, nearly one-third of spending projected under baseline assumptions.

Commodity Credit Corporation (CCC). The budget includes outlay reductions of $19.3 billion over the 1991-1995 period in the CCC's farm price support programs. Virtually all of this reduction would come from unspecified cuts, beginning with $1.5 billion in 1991 and rising

each year to $5.4 billion in 1995. These unspecified reductions total $19.2 billion--29 percent of the Administration's current services estimate of CCC spending and 36 percent of CCC spending projected under CBO baseline assumptions.

The Administration has not yet indicated what cuts are envisioned, either in the budget presentation or in testimony to the Congress on the farm bill. It has, however, indicated its intent to work with the Congress to develop legislation that would accomplish the indicated savings. The CBO estimate of the President's budget includes the Administration's savings estimates since they represent savings that could be realized through legislation. Most of these cuts would probably come from direct payments to farmers, which account for the bulk of CCC spending. If these savings were realized by reducing target prices, for example, CBO estimates that reductions of about 5 percent per year beginning with the 1991 crops would be needed to meet the Administration's savings goal. Other ways of cutting direct payments to farmers include cutting the acreage on which payments are made or further limiting payments per farmer.

Crop Insurance. The Administration proposes to terminate the current crop insurance program effective with the 1991 crop year. This action would eliminate both administrative expenses and net indemnity payments to farmers. CBO estimates savings of $0.2 billion in 1991 and $3.4 billion over the 1991-1995 period from eliminating the program. Even though the Administration has proposed to replace crop insurance with a permanent disaster assistance program, the budget includes no details of this program and no future costs for such disaster assistance. The CBO baseline does not assume disaster assistance in future years, so any proposal for permanent disaster assistance would increase outlays relative to the baseline.

Agricultural Credit Insurance Fund (ACIF). As in several recent budgets, the President proposes to reduce the level of direct loans to farmers as well as the level of federal guarantees of private loans. The President requests $525 million in new authority for direct loans for farm operation and ownership in 1991, and a $50 million decrease in the limit each year thereafter. (The limit on such direct loans in 1990 is $981 million.) The budget also includes a new funding request of $33 million in 1991 to provide interest subsidies for some guaranteed

loans. These ACIF proposals would save about $2.9 billion over five years relative to the CBO baseline.

Temporary Emergency Food Assistance Program (TEFAP). The Administration proposes to continue annual funding of commodity purchases under TEFAP at the 1990 level of $120 million, but requires purchases to come first from surplus CCC inventories. The CBO baseline includes no TEFAP spending after 1990, because under current law the program expires this year. The program's extension would add $0.6 billion to TEFAP outlays and $0.2 billion to CCC receipts over five years.

Other. The Administration's proposals for other agriculture programs would result in net savings of $0.1 billion to $0.2 billion a year compared with the CBO baseline. The budget includes proposed user fees, especially for the Animal and Plant Health Inspection Service, that would result in savings of almost $0.5 billion over the 1991-1995 period. Proposed spending for the Extension Service and the Agricultural Research Service is below the baseline. In contrast, the Agricultural Marketing Service and the Cooperative State Research Service are slated for increases totaling $0.2 billion above the CBO baseline over the 1991-1995 period.

CBO Reestimates

CBO estimates outlays for agriculture programs that are lower than the Administration's estimates in each year through 1995. The difference is $1.1 billion in 1990, $0.7 billion in 1991, and an average of about $3 billion each year thereafter.

CBO estimates that agriculture outlays in 1990 will be $1.1 billion less than projected by the Administration, mainly because of lower CCC spending. Major crop program outlays will be about $0.6 billion lower than projected by the President because CBO expects corn prices for the 1989 marketing year to be about $0.10 per bushel higher, resulting in lower deficiency payments and outlays for nonrecourse loans. CBO's estimate is below the Administration's by another $0.3 billion, mainly because CBO assumes that crop insurance indemnity payments for the 1990 crops will be disbursed at the recent historical

rate rather than at the greatly accelerated rate assumed by the Administration.

In 1991, CBO estimates that agriculture outlays under the President's budget would be $0.7 billion lower than the Administration estimates. ACIF outlays are expected to be $0.3 billion higher, mainly because CBO projects sales of property in inventory to be lower than estimated in the President's budget. CBO also projects that CCC outlays would be $1.1 billion lower, with $0.4 billion of that difference caused by higher estimated 1990 crop prices, particularly for corn and wheat. CBO's price assumptions are based on recent USDA reports that reflect smaller corn stocks and less acreage planted to wheat than was expected when the Administration made its projections. Lower estimates of corn and wheat deficiency payments are partly offset by higher expected cash redemptions of generic commodity certificates and defaults on export credit loan guarantees. Another $0.5 billion of the 1991 CCC difference occurs because, unlike the Administration,

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	14.6	14.9	15.6	13.5	11.8	10.4
CBO Reestimates						
Commodity Credit Corporation						
Market assumptions	-0.6	-0.4	-1.8	-2.4	-1.7	-2.0
Working capital change	0	-0.5	-0.8	-1.0	-1.0	-1.0
Other adjustments	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Subtotal	-0.8	-1.1	-2.7	-3.5	-2.8	-3.1
Other	-0.3	0.4	a	0.1	0.1	0.3
Total	-1.1	-0.7	-2.7	-3.4	-2.7	-2.8
President's 1991 Budget as Estimated by CBO	13.5	14.3	13.0	10.1	9.2	7.5

a. Less than $50 million.

CBO does not project any change in working capital, which has historically averaged near zero.

For 1992 through 1995, CBO outlay reestimates result primarily from differences in CCC estimates, mostly reflecting lower corn stocks and higher corn prices than assumed by the Administration, and differences in the assumption about working capital. CBO's outlay estimates for the CCC average about $3 billion per year below the Administration's over the 1992-1995 period.

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FUNCTION 370: COMMERCE AND HOUSING CREDIT

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline						
On-budget	46.4	6.2	16.5	4.1	6.4	
Off-budget[a]	0.7	-0.8	0.8	-1.3	-0.4	
Proposed Changes						
On-budget						
Rural Housing Insurance Fund	-0.7	-1.0	-1.3	-1.6	-1.8	-6.4
Federal Housing Administration Fund	-0.4	-0.4	-0.4	-0.4	-0.4	-2.0
Periodic censuses	-0.9	-1.2	-1.3	-1.5	-1.5	-6.4
Small Business Administration	-0.2	-0.2	-0.2	-0.2	-0.3	-1.1
Other	-0.1	-0.1	-0.1	-0.3	-0.3	-0.9
Total	-2.2	-2.9	-3.4	-3.9	-4.3	-16.8
Off-budget (Postal Service Fund)	0.8	0	0	0	0	0.8
President's 1991 Budget as Estimated by CBO						
On-budget	44.2	3.3	13.1	0.2	2.0	
Off-budget[a]	1.5	-0.8	0.8	-1.3	-0.4	

a. Postal Service Fund, which was taken off-budget by the Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239).

Proposed Policy Changes

The Administration's proposals for spending for commerce and housing credit are lower than baseline estimates in all years. The budget would shift emphasis from direct loan programs for rural housing and small business assistance to guaranteed loans, and would increase guarantee fees. Mortgage insurance income would be increased, while census activities would be reduced to reflect completion of the decennial census. Savings would total $2.2 billion in 1991 and $16.8 billion over the 1991-1995 period relative to the CBO baseline.

Rural Housing Insurance Fund (RHIF). The President's budget includes significant changes to the Farmers Home Administration's rural housing programs. Currently, most of this assistance is provided in the form of subsidized direct mortgage loans to low-income households or to developers of low-income rental housing. Beginning in 1991, the President proposes to replace some direct federal loans with subsidized and unsubsidized guaranteed private loans. The budget for 1991 includes slightly more than $1 billion in direct loan authority and $594 million for guarantees, compared with $2 billion in direct loan authority in 1990. (Last year's budget request included only $100 million in RHIF direct loans.) According to Administration estimates, the 1991 request would provide direct loans for about 24,260 households and guarantees for another 10,400 borrowers, compared with 44,700 units assisted in 1990.

Low-income borrowers with guaranteed loans would benefit from federal subsidies that would reduce effective interest rates on their loans by an average of five percentage points. To fund these interest subsidy payments, the President is requesting $362 million in 1991, which is estimated to be sufficient to support 30 years of subsidies for about 5,200 loans. Moderate-income borrowers with loan guarantees would receive no assistance beyond the guarantee. In total, the President's budget proposals would lower RHIF outlays by $0.7 billion in 1991 and by $6.4 billion over the 1991-1995 period.

The Administration proposes to implement a rental voucher program patterned after that operated by the Department of Housing and Urban Development. The $190 million requested for 1991 would assist more than 7,000 units for five years and would partially offset the proposed cuts in loan authority. This program would be included in function 600.

Federal Housing Administration (FHA). The President's budget includes a proposal to extend the higher 1990 mortgage limits for FHA's single-family insurance to 1991 and beyond through a permanent change in the authorizing statute. These limits were increased--for fiscal year 1990 only--in the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act (Public Law 101-144). A permanent increase in the limit would bring in additional receipts in the short run, because FHA would

insure more mortgages and collect additional up-front premiums. Claims would also increase, but over many years.

In addition, the Administration proposes to offer cash settlements to mortgage lenders to prevent claims on certain mortgages that are not in default but are eligible for assignment to FHA. These loans are covered by Section 221(g)(4) of the National Housing Act, which allows lenders to assign them to FHA after 20 years and to receive full payment of the outstanding principal. Together, these changes would reduce outlays by $0.4 billion in 1991 and by $2.0 billion over the next five years relative to the CBO baseline.

Periodic Censuses. In 1990, the Census Bureau received an unusually high appropriation of $1.3 billion for periodic censuses and programs to fund the decennial census. Consistent with the provisions of the Balanced Budget Act, the CBO baseline projects a continuation of this high level of funding, while the President proposes 1991 funding of $316 million to reflect completion of the decennial census. The President's proposal would reduce outlays by about $0.9 billion in 1991 and by $6.4 billion over the five-year period relative to the CBO baseline.

Small Business Administration (SBA). About $1.1 billion of the five-year savings relative to the CBO baseline is achieved through SBA programs. The President proposes to convert all SBA direct lending to guaranteed lending, except for certain direct loans to minority-owned firms, and to increase the fees that are charged on guaranteed loans. This proposal, which is similar to ones in previous budgets, would reduce outlays by about $0.7 billion over the five-year period relative to the CBO baseline. In addition, the budget includes funding for SBA salaries and expenses below the CBO baseline, with outlay savings totaling $0.4 billion over the five-year period. Much of these savings would result from the gradual elimination of grants to small business development centers.

Other. The Administration is proposing sharp reductions in the Department of Housing and Urban Development's elderly and handicapped housing direct loan program. The $283 million of direct loan authority requested could assist almost 4,000 units, compared with the CBO baseline authority level of $492 million for about 7,000 units. Outlays in 1991 would not be affected, but over the next five years they would be $0.3 billion below the baseline.

The President's budget also contains a legislative proposal that would increase the Government National Mortgage Association's mortgage-backed security guarantee fee from 6 to 10 basis points. This proposal would lower outlays by an estimated $8 million in 1991 and $0.3 billion over the 1991-1995 period.

Postal Service (Off-Budget). The President is proposing to increase Postal Service payments to the Civil Service Retirement Fund (see function 950) and to the Federal Employees Health Benefits Fund (see function 550). These increases, totaling $7.8 billion over the next five years, are intragovernmental transactions and would be reflected as offsetting receipts in functions 950 and 550, respectively. To recover these costs, the Postal Service is likely to increase postal rates, resulting in net savings to the federal government. The Postal Service surplus or deficit, which is off-budget, would be unaffected once the additional costs are covered by higher rates. The savings would appear in the on-budget retirement and health benefits funds.

In addition, the President is proposing to terminate or restrict certain preferred postage rates and eliminate the portion of the appropriated subsidy that covers these reduced rates. These changes would save almost $100 million in 1991, relative to the CBO baseline, and almost $400 million over the 1991-1995 period. The President also proposes to establish a separate subclass for government mail, which would reduce the need for appropriations by $220 million annually (see function 920). To recover these revenue losses, the Postal Service is likely to increase postal rates, resulting in net savings to the federal government.

The baseline assumes that first-class postage will be increased to 30 cents in February 1991 without these proposals. Covering the full cost of these proposals through rate changes would necessitate an additional increase approximately equivalent to one cent in the price of first-class postage. These changes would result in reduced appropriations of $1.5 billion (shown mostly in function 920) and increased receipts of $7.8 billion (in functions 950 and 550), for a net spending reduction of about $9.3 billion (on-budget) relative to the baseline over the five-year period. The Postal Service could recover, through higher postal rates, only about half of the additional costs and revenue losses in 1991. As a result, net outlays of the off-budget Postal Service would

increase by $0.8 billion in 1991; this amount would not be counted for purposes of the Balanced Budget Act.

CBO Reestimates

CBO's estimate of outlays for this function exceeds the Administration's by more than $30 billion in 1990 and about $29 billion for 1991, largely because of substantially higher outlay estimates for the Resolution Trust Corporation (RTC) and the Bank Insurance Fund.

Resolution Trust Corporation Revolving Fund. CBO has reestimated the RTC's net outlays in the President's budget upward by $31 billion in 1990 and $24 billion in 1991, largely to reflect additional spending of working capital by the RTC. CBO expects that the RTC will borrow about $55 billion from the Federal Financing Bank over the next two years to finance the purchase of assets from failed savings and loans. Over the 1992-1995 period, when most of the assets would be sold, outlays would be an estimated $43 billion lower than the budget figures. (See Appendix A for more details on RTC spending.)

Federal Deposit Insurance Corporation's Bank Insurance Fund. Over the five-year period, CBO's estimate of outlays from the fund exceeds the amounts estimated in the President's budget by close to $5 billion each year. The CBO estimate assumes that current problems facing banks will result in greater demands upon the fund than the Administration anticipates. These problems include regional real estate downturns, exposure to highly leveraged transactions, growing delinquency rates for consumer debt, and loans to less developed countries. Consequently, CBO estimates that the Federal Deposit Insurance Corporation will continue to provide assistance to failed and troubled banks in amounts that are similar to the historically high levels of assistance experienced in the past few years.

FSLIC Resolution Fund. This fund is the successor to the Federal Savings and Loan Insurance Corporation (FSLIC), and has assumed the liabilities and assets from thrift insurance failures through 1989. Disbursements from this fund mostly cover interest payments on outstanding debt of about $19 billion, and cash to maintain yields or pay capital losses on assets purchased from failed thrifts. A portion of insurance premiums, plus proceeds from asset liquidations, help offset

these costs, with Treasury appropriations paying the difference. CBO estimates that outlays will be higher than the Administration's estimates in 1991 and 1992, by $0.6 billion and $0.7 billion, respectively, but lower by an estimated $0.2 billion to $0.8 billion in the 1993-1995 period, largely reflecting differing assumptions about the size and timing of payments for past losses, which are highly uncertain.

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget						
On-budget	20.3	15.5	9.6	9.5	7.8	6.6
Off-budget[a]	2.4	0.9	0.7	0.1	-0.1	-0.4
CBO Reestimates						
On-budget						
Resolution Trust Corporation Revolving Fund	30.7	23.7	-13.0	-13.0	-10.0	-7.0
FDIC Bank Insurance Fund	0.5	4.7	4.9	5.1	4.7	4.8
FSLIC Resolution Fund	b	0.6	0.7	-0.2	-0.8	-0.5
Savings Association Insurance Fund	0	0	1.3	12.2	-0.3	-0.2
Treasury interest payment to REFCORP	-0.4	0.3	0.1	0.1	0.1	0.1
Federal Housing Administration Fund	-0.7	-0.6	-0.5	-0.8	-1.5	-2.0
Other	0.1	0.1	0.2	0.2	0.2	0.3
Total	30.3	28.8	-6.3	3.6	-7.6	-4.6
Off-budget (Postal Service Fund)	b	-0.2	-1.5	0.7	-1.2	-0.1
President's 1991 Budget as Estimated by CBO						
On-budget	50.6	44.2	3.3	13.1	0.2	2.0
Off-budget[a]	2.4	0.7	-0.8	0.8	-1.3	-0.4

NOTE: FDIC = Federal Deposit Insurance Corporation; FSLIC = Federal Savings and Loan Insurance Corporation; REFCORP = Resolution Funding Corporation.

a. Postal Service Fund, which was taken off-budget by the Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239).

b. Less than $50 million.

Savings Association Insurance Fund (SAIF). This fund will assume responsibility for new thrift insolvencies beginning in 1992. CBO projects that SAIF outlays in 1992 will exceed the Administration's estimate by $1.3 billion, because the likely caseload of insolvent thrifts will require use of the entire $4 billion permitted to be obligated in that year. When the obligation cap is lifted in 1993, CBO expects that the SAIF will spend $16 billion for case resolutions, $12.2 billion more than assumed in the President's budget.

Treasury Interest Payment to the Resolution Funding Corporation (REFCORP). In 1990, CBO estimates that Treasury payments to bondholders for interest costs associated with REFCORP borrowing will be made in April and July for bonds issued in October 1989 and January 1990. The Administration has different assumptions about the timing of payments, and CBO expects the Treasury to pay $0.4 billion less than estimated in the President's budget for 1990. In subsequent years, these payments are expected to be higher by $0.3 billion in 1991, and by $0.1 billion in each year thereafter.

Federal Housing Administration Fund. CBO's estimates of net outlays for the FHA are lower than the Administration's in each year of the 1991-1995 period. This difference increases from $0.6 billion for 1991 to $2.0 billion for 1995, and amounts to $5.4 billion over the entire period. The Administration's estimates are based on much higher levels of annual claims payments, particularly single-family claims. CBO's claims estimates are based on historical claims rates that reflect the age of loans in FHA's portfolio.

Postal Service Fund (Off-Budget). CBO estimates of Postal Service outlays are different from the Administration's because the budget does not reflect the large year-to-year swings in net operating income that result from periodic rate increases. Over the 1991-1995 period, CBO's estimates of Postal Service outlays are about $2.3 billion below the Administration's.

FUNCTION 400: TRANSPORTATION

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	30.7	32.0	33.1	34.4	35.7	
Proposed Changes						
Federal-aid Highways	-0.2	-1.0	-1.8	-2.4	-2.9	-8.3
Mass transit	-0.4	-0.6	-0.7	-0.9	-1.1	-3.7
Amtrak	-0.6	-0.7	-0.7	-0.7	-0.7	-3.4
FAA operations	a	0.2	0.4	0.7	0.9	2.2
FAA facilities and equipment	0.1	0.3	0.6	0.7	0.8	2.5
Coast Guard operating expenses	0.2	0.2	0.2	0.2	0.2	1.0
Coast Guard user fees	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1
Other	a	-0.1	-0.3	-0.4	-0.6	-1.4
Total	-1.2	-1.9	-2.4	-2.9	-3.6	-12.1
President's 1991 Budget as Estimated by CBO	29.6	30.0	30.7	31.4	32.0	
President's 1991 Budget	29.8	30.2	30.7	31.3	31.3	
CBO Reestimates	-0.2	-0.2	a	0.1	0.7	

NOTE: FAA = Federal Aviation Administration.

a. Less than $50 million.

Proposed Policy Changes

The Administration is proposing to hold ground transportation spending below the 1990 level through 1995, while increasing spending for air traffic control and for Coast Guard operations. In total, spending for the function would be $12.1 billion below the CBO baseline over the 1991-1995 period. For 1991, the budget includes a 6 percent cut in budget authority ($2.0 billion) relative to the CBO baseline, resulting in first-year outlay savings of $1.2 billion. Many of the proposals are similar to those in previous budgets, though the requested reductions in funding for mass transit are less severe.

Ground Transportation. Reductions in spending for ground transportation, particularly Federal-aid Highways, would account for most of the savings in this function. Under the Administration's proposal, total obligations for Federal-aid Highways in 1991 would be $13.6 billion--$1.2 billion below the CBO baseline and $0.5 billion below estimated 1990 obligations. The difference in obligations relative to the baseline would increase in future years, with total outlay savings of $8.3 billion over the five years. About $2 billion of this difference occurs because the baseline, consistent with the provisions of the Balanced Budget Act, assumes future appropriations of more than $1 billion a year for emergency relief, as was provided in 1990 in response to the Loma Prieta earthquake in California. The budget includes no such funds. The bulk of the savings is from proposals to reduce the obligation ceiling below the 1990 level, include currently exempt demonstration projects under the ceiling, and eliminate a provision that allows certain states to incur additional obligations in the last two months of the fiscal year.

The 1991 budget includes budget authority for transit programs totaling $2.6 billion--$0.6 billion below the 1990 appropriation and $0.8 billion below the CBO baseline. The Administration proposes to eliminate operating assistance to large urban areas and to place funding for interstate transfer grants for transit projects under the Federal-aid Highways obligation ceiling. Over the five-year period, outlay savings for transit programs, relative to the baseline, would total $3.7 billion.

The Administration also proposes to eliminate all subsidies for Amtrak, reducing outlays over the five years by $3.4 billion, relative to the baseline.

Air Transportation. Aviation is targeted for significant funding increases in 1991. Most of this increase would be used to modernize and improve the air traffic control system. Under the President's budget, spending authority for Federal Aviation Administration (FAA) facilities and equipment would be increased from $1.7 billion in 1990 to $2.5 billion in 1991--a 45 percent increase--and would average $2.75 billion a year from 1992 through 1995. Additional funds for FAA operations would be used to hire more air traffic controllers, safety inspectors, and security specialists. The Administration proposes to derive 85 percent of the funds for the FAA from the Airport and Air-

way Trust Fund over the 1991-1995 period, compared with 58 percent in 1990. Under the President's revenue assumptions (which include a 25 percent increase in most aviation tax rates), funds would be available in the Airport and Airway Trust Fund to support this spending. The fund's surplus would, however, decline gradually over time.

Water Transportation. The President's proposals for water transportation would result in net outlay savings of about $40 million in fiscal year 1991 and $0.2 billion through 1995, relative to the CBO baseline. The 1991 appropriation for U.S. Coast Guard operations would be about $200 million, or 9 percent, above the baseline. This increase in spending would be offset by proposed user fees of similar amounts, as well as funding cuts of about $40 million for the Coast Guard's acquisition programs.

CBO Reestimates

CBO estimates that spending under the President's policies would be slightly lower than the Administration estimates in 1991 and 1992, but somewhat higher in 1994 and 1995. In general, these reestimates result from different assumptions about the rate of spending for mass transit programs and Coast Guard operating expenses.

FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	8.5	8.6	8.6	8.9	9.1	
Proposed Changes						
Community development programs	a	-0.1	-0.3	-0.4	-0.5	-1.3
Regional development programs	-0.2	-0.5	-0.8	-1.0	-1.1	-3.6
Disaster relief and insurance	-0.6	-1.4	-1.5	-1.6	-1.6	-6.6
Total	-0.8	-2.0	-2.5	-2.9	-3.3	-11.5
President's 1991 Budget as Estimated by CBO	7.7	6.6	6.1	5.9	5.8	
President's 1991 Budget	7.8	6.5	6.1	5.9	6.2	
CBO Reestimates	-0.1	0.1	-0.1	a	-0.4	

a. Less than $50 million.

Proposed Policy Changes

The 1991 budget proposes substantial reductions in community and regional development programs relative to CBO's baseline. Total five-year savings would be $11.5 billion, or about 26 percent of total spending in this function. But these figures overstate the programmatic impact of the Administration's proposals. Much of these savings would come from disaster relief programs, because the CBO baseline would continue at the unusually high 1990 program levels while the President's budget assumes that funding in 1991 and beyond will return to average levels. Excluding the reductions in disaster relief spending, the budget would result in a 14 percent decline in other function 450 outlays over the 1991-1995 period.

Community Development. Administration proposals for community development programs, which focus primarily on housing and economic development in urban areas, would result in net savings of $1.3 billion from 1991 through 1995. Most of the savings would come from reducing funding for the Community Development Block Grant (CDBG) program, from $2.9 billion in 1990 to $2.75 billion per year thereafter, which would generate five-year savings of $1.5 billion.

The President would also eliminate the Section 108 loan guarantee program, which provides federal guarantees to enable cities to finance community development activities over an extended period. Other proposals would eliminate the Section 312 rehabilitation loan program and would reduce funding for rental rehabilitation grants. These initiatives, which have been proposed in previous budgets, would result in savings of an additional $0.5 billion in outlays over five years.

These reductions would be partially offset by a number of housing and management initiatives that would increase outlays by $0.7 billion relative to the CBO baseline over the 1991-1995 period. The budget proposes changing the nature of the Supplemental Facilities to Assist the Homeless program, from a focus on providing temporary shelter for the homeless to giving them rental assistance. Appropriations for the program, which is part of the HOPE initiative (Homeownership and Opportunity for People Everywhere), would be increased from $11 million in 1990 to $161 million in 1991, and outlays would exceed the baseline by almost $300 million over the five years. The Administration would also increase funding for the existing urban homesteading program from $24 million in 1990 to $50 million in 1991, with outlays about $200 million above CBO's baseline projections over the 1991-1995 period. Other proposals would increase appropriations and outlays for research, increased staffing, and computer systems by about $200 million over five years, to enhance the Department of Housing and Urban Development's management and evaluation capabilities.

Area and Regional Development. Once again, the budget proposes to scale back funding for rural economic development programs and to eliminate the Economic Development Administration. Over five years, these proposals would save $3.6 billion, which represents a de-

crease of about 23 percent from CBO baseline projections for area and regional development programs.

The President proposes a reduction in funding for rural water and waste grants, and would shift financing of rural water and waste and other community facilities from direct loans to loan guarantees. Direct loans would be reduced from $450 million in 1990 to $220 million in 1995, to be replaced by loan guarantees. These proposals would generate outlay savings of $0.7 billion over five years relative to the CBO baseline. The rural business and industry loan program of the Farmers Home Administration would also be eliminated.

The budget would terminate the Economic Development Administration, saving $0.7 billion over five years. It would also reduce loan levels and raise interest rates in the Rural Telephone Bank, and would reduce funding for Bureau of Indian Affairs programs, the Appalachian Regional Commission, and the Tennessee Valley Authority's rural development programs. These proposals would save another $2.2 billion relative to the baseline over the 1991-1995 period.

Disaster Relief and Insurance. Two programs--the disaster relief fund of the Federal Emergency Management Agency and funds appropriated to the President for unanticipated needs for natural disasters--were funded at unusually high levels in 1990 because of the damages that resulted from Hurricane Hugo and the Loma Prieta earthquake in California. In accordance with the procedures of the Balanced Budget Act, the CBO baseline projects a continuation of this high level of funding for these two accounts ($1.5 billion in 1991), while the President proposes to fund these accounts at historically average levels ($0.3 billion a year). The President's proposal would reduce outlays by about $5.4 billion over the five-year period relative to the CBO baseline.

About $1.2 billion of the five-year savings relative to the CBO baseline results from changes in other disaster assistance and insurance programs. The President is proposing to limit Small Business Administration (SBA) disaster loans only to those unable to obtain loans from private lenders. In addition, the interest rate on such disaster loans would be increased to the Treasury cost of borrowing. These proposals for the SBA program would reduce outlays by $0.6 billion over five years relative to the CBO baseline.

Finally, the President's budget assumes that the National Flood Insurance Fund (NFIF) will be reauthorized upon its expiration on September 30, 1991. The baseline assumes the program expires and premium income to the fund ends, although the insurance policies would remain in force for up to three years. Reauthorizing the NFIF would result in five-year outlay savings of $0.6 billion relative to the CBO baseline. In the long term, however, the additional premium income would be roughly offset by additional operating and claims costs.

CBO Reestimates

CBO's estimates of outlays for function 450 are very close to the Administration's through 1994. For 1995, CBO's estimate of outlays for urban development action grants is about $0.2 billion less than the Administration's because of different assumptions about spending rates.

FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	41.3	42.9	44.0	45.4	47.0	
Proposed Changes						
Preschool, elementary, and secondary education						
Head Start	0.2	0.4	0.4	0.4	0.4	1.8
Other	a	0.2	a	-0.3	-0.8	-0.9
Higher education						
Grants	a	-0.1	-0.5	-0.7	-0.8	-2.0
Loans	-0.2	-0.1	-0.2	-0.3	-0.3	-1.1
Education-related programs	a	a	-0.1	-0.2	-0.3	-0.6
Training and employment	-0.1	-0.2	-0.3	-0.5	-0.7	-1.9
Social services						
Child care tax credits	0.2	1.8	2.0	2.1	2.3	8.5
Legalization grants	-0.2	-0.4	-0.4	-0.1	a	-1.1
Foster Care and Adoption Assistance	-0.1	-0.1	-0.2	-0.4	-0.5	-1.3
Community Services Block Grant	-0.3	-0.4	-0.4	-0.4	-0.4	-1.9
Other	0.1	a	a	-0.1	-0.2	-0.1
Total	-0.4	1.3	0.2	-0.4	-1.3	-0.7
President's 1991 Budget as Estimated by CBO	40.9	44.1	44.2	45.0	45.7	

a. Less than $50 million.

Proposed Policy Changes

The President's proposals would reduce spending for education, job training, employment, and social service programs by $0.7 billion--or less than one-half of 1 percent--below CBO's baseline projections over the 1991-1995 period. Underlying this small change in the total, however, are major spending increases and decreases, many proposed in previous budgets. Many current programs are held below baseline levels. Federal spending for education and training would decrease

despite the budget's discussion of their importance for future economic growth. One major exception is spending on Head Start, which would rise by $1.8 billion over five years. Under the President's plan, the tax system would become an important distributor of social service monies. A new refundable child care tax credit and reform of the existing dependent care tax credit would raise spending by $8.5 billion over five years. Five-year spending for other social service programs would decline by $4.4 billion.

Preschool, Elementary, and Secondary Education. In 1991, the President's budget would fund preschool, elementary, and secondary education programs at $14.0 billion, an increase of almost 7 percent from the CBO baseline projection. By 1995, however, funding would be $14.4 billion, a decline of 6 percent from the CBO baseline, which inflates spending in future years. Over the five-year period, spending would rise by $0.9 billion, or just over 1 percent.

Most of the increased funding would be for preschool education, especially for the Head Start program, which was highlighted in the President's budget. Head Start, which provides comprehensive services to low-income children, would be funded at $1.9 billion in 1991--an increase of about one-third from CBO's baseline projection. The higher funding level would be maintained over the five years after allowing for projected inflation, and five-year spending would rise by $1.8 billion. New Head Start monies could be used to enroll about 175,000 more children or to improve the educational services available to the 450,000 current participants.

For elementary and secondary education, the President proposes funding of $11.9 billion in 1991, an increase of almost 4 percent from CBO's baseline. Funding for these programs increases more gradually after 1991, failing to keep pace with projected inflation, so that by 1995 funding would be 9 percent below CBO's baseline. Spending over the five-year period would be $0.9 billion lower (including a $0.1 billion reduction for preschool programs).

The President's budget proposes several new initiatives, such as Presidential Merit Schools and teacher certification programs, and substantial increases in 1991 funding for Drug-Free Schools, Magnet Schools, Mathematics and Science Education, and Adult Education. Some other programs, such as Compensatory Education (Chapter 1),

would receive modest funding increases above inflation in 1991, while most other programs would receive less than full inflation adjustments. The budget proposes again to virtually eliminate Impact Aid "b" grants.

Higher Education. The President's budget proposes funding for higher education grants, loans, and loan subsidies at $10.8 billion in 1991, close to CBO's baseline projection. However, outlays would decline by $0.2 billion in 1991 from sales of loan assets. By 1995, funding would be $1.2 billion, or almost 11 percent, below the baseline.

Federal grant programs for aid to students and institutions would account for almost two-thirds of the five-year spending decline. Most of the spending reductions result from eliminating grants for Perkins loan capital and State Student Incentive Grants and freezing Work Study Grants and Supplemental Education Opportunity Grants. The President proposes modest changes in Pell grants, the largest grant program. Students without high school diplomas who do not pass an independently administered test would not receive aid, while those attending school less than half-time would qualify for aid. Together, these proposals are estimated to reduce participation marginally. Although tuition costs have been rising at almost twice the rate of inflation, the President proposes to limit the maximum level for the neediest students to the 1990 level of $2,300.

The President's budget would continue current efforts to reduce student loan defaults in the Stafford Student Loan Program. The budget includes a proposal that would shift some federal costs of loan defaults to the guaranteeing agencies by increasing insurance fees and lowering the proportion of a loan that is insured. In addition, the budget would tighten requirements for loans to first-time students and, as for Pell grants, would make it more difficult for students without a high school diploma to qualify for loans. Estimated five-year savings for these changes would total $0.9 billion.

In 1991, the President proposes to sell more college housing and facilities loans. Loan assets with a face value of approximately $400 million are to be sold, with proceeds totaling an estimated $235 million.

Education-Related Programs. Education-related programs, including those in the arts and humanities, would be funded at $3.9 billion in 1991, virtually identical to the CBO baseline. As with other education programs, funding would be lower by 1995. Over five years, spending for education-related programs would decline by $0.6 billion. The Administration's requested 1991 funding for education research, construction of a new Smithsonian museum, and operation of the Library of Congress and the Department of Education would be an increase relative to CBO's baseline. These funding increases would be more than offset over the five-year period by the proposed elimination of grants for public libraries and public telecommunications and reduced support, relative to the baseline projections, for the Corporation for Public Broadcasting, the National Endowments for the Arts and for the Humanities, and other educational programs.

Training and Employment. The budget proposes to fund training and employment services at the baseline level of $6.6 billion in 1991 and to reduce funding by just under 10 percent by 1995. Spending would decline by $1.9 billion over five years. Funds for training of welfare recipients, however, would increase, as mandated by the Family Support Act of 1988; these funds are shown in function 600.

As in recent years, the President's budget proposes a single discretionary program (Worker Readjustment) to serve dislocated workers--those who have worked for several years and whose jobs have been eliminated. This program would replace Trade Adjustment Assistance training programs (as well as cash payments in function 600) and the Job Training Partnership Act (JTPA) program for dislocated workers. Funding of $0.4 billion--28 percent lower than the CBO baseline estimate for the existing programs--is requested in 1991. Because the President requests constant funding for the new program over the five-year period while CBO's baseline rises with inflation, the funding request is 40 percent below the baseline in 1995. A second major reduction, accounting for $0.7 billion of the $1.9 billion of reduced spending in employment and training, is in funding for administration of the Employment Service program.

At the same time, the Administration proposes to retarget JTPA funds on people who are most in need of training by replacing the existing block grant and summer youth programs with separate year-round programs for low-income adults and youth. Also, a new

Youth Opportunities Unlimited grant program is proposed to provide comprehensive services to youth living in high-poverty areas. Additional funding of $0.3 billion a year would be available for these programs.

Social Services. The President's budget proposes a new spending initiative through the tax system (refundable portions of the child tax credits) increasing spending by $8.5 billion over five years and major reductions, totalling $4.3 billion, in three programs (Legalization Impact Assistance Grants, Foster Care and Adoption Assistance, and the Community Services Block Grant). Other changes in social service programs--except for Head Start, which was discussed above--are modest.

In order to assist low-income families who have earnings and children, the Administration again proposes to create a new refundable child care tax credit. The new credit--14 percent of the parents' earnings up to a maximum credit of $1,000 for each child under the age of four--would be available to all families with earnings. In 1991, the credit would be phased out gradually for families with incomes over $8,000, and would be completely phased out for incomes of $13,000 or more. In addition, the Administration proposes making the existing tax credit for child and dependent care refundable, thus helping families with incomes too low to require the payment of federal income taxes. As a result, more than 3 million additional families would be assisted in 1991. These two proposals would raise spending by $2.3 billion in 1995, and by $8.5 billion over five years.

The President's budget proposes to reduce funding for State Legalization Impact Assistance Grants (SLIAG) to $0.3 billion in 1991 and to zero in 1992, resulting in estimated outlay savings of $1.1 billion over the five-year period. These grants go to states to pay for certain costs of the legalization of undocumented aliens required by the Immigration Reform and Control Act of 1986. States have been spending the federal funds much more slowly than expected, and by the end of 1989 unspent balances reached $1.5 billion. At this time, however, it is not clear to what extent state costs associated with the legalized aliens are below original projections and to what extent spending is simply delayed because states are having difficulty documenting and claiming legitimate costs.

In the Foster Care program, the Administration proposes to limit administrative costs to a maximum growth of 10 percent a year in each state, saving $0.1 billion in 1991. Annual savings in 1995 would increase to $0.5 billion, or 14 percent of outlays for foster care and adoption assistance. Administrative costs have been growing much faster than caseloads in recent years, and their growth--in the absence of any legislation--is expected to continue at a rate of 24 percent in 1991, declining to 18 percent in 1995. CBO's projections of growth rates are lower than the Administration's projections--35 percent in 1991, declining to 14 percent in 1995--and thus CBO estimates are lower for both baseline spending and legislative savings.

Once again, the President proposes eliminating the Community Services Block Grant program, reducing spending by $1.9 billion over five years. The program would be eliminated in 1991.

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	37.7	41.0	42.9	43.5	44.1	44.9
CBO Reestimates						
Economic						
Interest rates	a	0.5	0.8	0.8	0.7	0.6
Other	a	a	a	a	0.1	0.1
Subtotal	a	0.5	0.8	0.8	0.8	0.7
Technical						
Education	0.7	-0.5	0.1	-0.1	0.2	0.3
Other	0.1	-0.2	0.3	a	-0.1	-0.1
Subtotal	0.8	-0.7	0.4	-0.1	0.1	0.1
Total	0.8	-0.1	1.2	0.7	0.8	0.8
President's 1991 Budget as Estimated by CBO	38.4	40.9	44.1	44.2	45.0	45.7

a. Less than $50 million.

CBO Reestimates

The CBO reestimates of the President's budget are dominated by the economic reestimates, which raise spending by $0.5 billion in 1991 and $0.7 billion in 1995. CBO projects higher interest rates than the Administration and thus higher interest subsidies in the Stafford Student Loan Program.

CBO also projects $0.7 billion more spending for education in 1990, partially offset by $0.5 billion less spending in 1991. CBO estimates a faster use of available resources by state and local governments, reflecting historical spending patterns. Other technical reestimates are either small or largely offsetting.

FUNCTION 550: HEALTH

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	65.0	72.7	80.2	88.2	96.8	
Proposed Changes						
Federal Employees Health Benefits	-0.7	-0.8	-0.9	-1.0	-1.0	-4.4
Public Health Service	0.1	-0.1	-0.5	-0.8	-1.2	-2.5
Medicaid	-0.1	-0.1	-0.1	a	0.1	-0.2
Other	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Total	-0.9	-1.1	-1.5	-1.9	-2.3	-7.6
President's 1991 Budget as Estimated by CBO	64.2	71.7	78.7	86.3	94.5	

a. Less than $50 million.

Proposed Policy Changes

The President's 1991 budget proposes spending cuts that would reduce health expenditures by $7.6 billion over the 1991-1995 period. The largest reductions are proposed in the Federal Employees Health Benefits (FEHB) program and the Public Health Service (PHS). Small net reductions are proposed in Medicaid, primarily as a result of new user fees. This budget differs significantly from those in the Reagan years, because it does not propose large Medicaid reductions.

Federal Employees Health Benefits Fund. The President's budget for the FEHB program would reduce federal spending for annuitants' health benefits by transferring responsibility for annuitants who retired from the Postal Service between October 1, 1971, and October 1, 1986, to the Postal Service. The District of Columbia would also assume responsibility for its annuitants. This action would save $0.7 billion in 1991 and $4.4 billion over five years. Total premium payments and overall benefits under the FEHB program would not change. An

additional proposal to change the financing of FEHB benefits is discussed under the function for allowances (920).

Public Health Service. The Administration would slow the growth rate of PHS funding to about 4 percent in 1991, and to approximately 2 percent in 1992 through 1995. Slowing the growth rate would hold spending for the discretionary health programs below the CBO baseline, saving $1.2 billion in 1995.

Within the PHS, the Administration's funding request for the National Institutes of Health (NIH) is at baseline levels in 1991 and then falls progressively further below the CBO baseline in 1992 through 1995. NIH spending would fall below the baseline by $0.7 billion in 1995.

As in previous budgets, most health profession grants within the Health Resources and Services Administration (HRSA) would be eliminated, and the growth in HRSA funding would be held below baseline levels. Savings would grow from $0.1 billion in 1991 to $0.4 billion in 1995.

Funding for the Alcohol, Drug Abuse, and Mental Health Administration (ADAMHA) would increase by 8 percent in 1991, reflecting the Administration's commitment to anti-drug abuse treatment and research programs. However, because funding grows more slowly than the CBO baseline in 1992 through 1995, spending for ADAMHA would be $0.1 billion lower than the baseline in 1995.

Finally, the Administration proposes to institute user fees for certain Food and Drug Administration (FDA) activities, such as product reviews, surveillance, and inspection services. Although these fees would reduce federal funding for the FDA by 10 percent in 1991, overall FDA activities would remain unchanged.

Medicaid. The rapidly growing Medicaid program would be reduced by $0.2 billion over five years under the President's request. The reductions would result from proposed user fees for providers and would not be fully offset by estimated increases from a managed care initiative and the effects on Medicaid of proposed changes in Medicare.

The President's budget proposes that certain Medicaid providers, primarily nursing homes, pay the costs of the government's survey and certification activities. These activities ensure that providers meet current Medicaid standards for quality of care and patient safety. Currently, these activities are jointly funded by federal, state, and local governments. Funding these activities by requiring providers to pay user fees would reduce federal spending by an estimated $0.7 billion over the five years.

Proposed changes to the Medicare program would raise Medicaid costs by an estimated $0.4 billion over the five years. These increases would result primarily from the Administration's proposal to set the Supplementary Medical Insurance premium at 25 percent of program costs, which Medicaid pays for approximately 3.8 million recipients.

Finally, the budget includes several legislative changes to encourage the use of managed care systems by state Medicaid programs. These systems involve arrangements with providers so that most health care is provided by a single group, an integrated network of health care providers, or an individual acting as a case manager. Some analysts believe that managed care systems can provide quality health care at reduced prices, but the evidence is mixed.

As an incentive to use managed care systems, the states would receive an increase of three percentage points, beginning in 1991, in the federal match rate for expenditures associated with increased enrollment in managed care plans. To offset any increase in federal costs caused by the enhanced match for certain managed care services, the federal match rate for services provided under traditional fee-for-service arrangements would then be reduced beginning in 1993. The proposal would be budget neutral by 1994. As an additional incentive to use managed care systems, states would be permitted to enroll beneficiaries without asking for waiver authority, which is currently required. Finally, a number of current restrictions on health maintenance or-ganizations would be lifted.

CBO estimates these initiatives would cost $70 million over the five- year period, roughly half of the Administration's estimate of $145 million. States have indicated that the need for state legislation, planning, provider licensure, and other factors would make it difficult for them to significantly increase the use of managed care in 1991. In

1992, the CBO estimate assumes that states would double the approximately 1.6 million Medicaid beneficiaries currently enrolled in managed care systems.

Other. The Administration proposes to convert the PHS Commission Corps Retirement program to an accrual-based system, similar to military and civilian retirement systems. Although this proposal would not change benefit payments over five years, it would transfer certain payments from the health function (550) to the income security function (600).

CBO Reestimates

CBO has reestimated the President's budget outlays downward by $0.9 billion in 1990 and upward by $0.5 billion in 1991 and $6.2 billion in 1995. Most of the upward change occurs in the Medicaid program, but technical differences are also found in the Public Health Service estimates.

CBO's Medicaid baseline is $0.7 billion lower than that of the Administration in 1990. The Administration's estimate is based primarily on state estimates submitted to the Health Care Financing Administration (HCFA). Based on conversations with state Medicaid staff, CBO believes that those spending estimates are too high. Over the 1991-1995 period, the CBO Medicaid estimates grow more rapidly than the Administration's. For example, the Administration's growth rate for 1992 is 10.7 percent compared with CBO's 12.6 percent. As a result, CBO's 1992 estimate is $1.0 billion higher than the Administration's. This discrepancy stems from differing assumptions about the effects of recent legislation. The main effects of the provisions for nursing home reform contained in the Omnibus Budget Reconciliation Act of 1987 will first be felt in 1992. These provisions will increase the cost of nursing home services, which represent over 42 percent of Medicaid expenditures. In the 1993-1995 period, the CBO baseline growth rate is about 11.5 percent, the average annual Medicaid growth rate for 1985 through 1989. In contrast, the Administration projects that Medicaid growth will slow to 8.8 percent by 1995--a rate that is lower than the actual growth rate in 23 of the last 25 years. The combination of CBO's higher estimate of 1992 outlays and the difference of about two to three percentage points in the growth rates for 1993 through

1995 make CBO's baseline $5.7 billion higher than the Administration's baseline in 1995.

The reestimates of the Administration's request for the Public Health Service are based on different spending assumptions. The CBO spending estimate of the President's request for the Health Resources and Services Administration exceeds the Administration's estimate by $0.3 billion in 1991 and $0.4 billion in 1995, for two reasons. First, the budget projects outlays to fall $0.2 billion below requested funding levels in 1992 through 1995, whereas CBO projects that outlays would follow budget authority more closely. Second, CBO estimates that total outlays from the Vaccine Injury Compensation Trust Fund will be approximately $0.2 billion to $0.3 billion higher than the Administration's projections from 1991 through 1995. CBO's estimate is based on information on the number of claims awarded, the average size of those awards, and the average lag between the time a deserving claim is filed and awarded. Because the program is just beginning, however, the estimates are very uncertain.

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	57.8	63.7	69.9	75.9	82.0	88.3
CBO Reestimates						
Economic (Cost-of-living adjustments)	0.0	0.0	0.0	a	a	a
Technical						
Medicaid	-0.7	0.1	1.0	2.1	3.7	5.7
Public Health Service	-0.2	0.4	0.7	0.7	0.6	0.6
Total	-0.9	0.5	1.7	2.8	4.3	6.2
President's 1991 Budget as Estimated by CBO	56.9	64.2	71.7	78.7	86.3	94.5

a. Less than $50 million.

FUNCTION 570: MEDICARE

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	104.9	120.0	135.0	151.4	168.8	
Proposed Changes						
Extensions of 1990 practices						
Hospital capital	-1.5	-1.9	-2.1	-2.3	-2.6	-10.4
Supplementary Medical Insurance premiums	0.0	-0.6	-1.7	-3.0	-4.5	-9.8
New physicians	-0.1	-0.1	-0.1	-0.1	-0.2	-0.6
Subtotal	-1.6	-2.5	-3.9	-5.5	-7.3	-20.8
Previously rejected proposals						
Medical education	-1.2	-1.5	-1.6	-1.8	-2.0	-8.1
Outpatient hospital services	-0.4	-0.5	-0.6	-0.7	-0.8	-3.0
Durable medical equipment	-0.1	-0.2	-0.2	-0.2	-0.2	-0.9
Subtotal	-1.7	-2.2	-2.4	-2.7	-3.0	-12.0
Other proposed changes						
Reduction in inflation-related updates	-1.0	-1.4	-1.6	-1.7	-1.9	-7.6
Accelerated transition to physician fee reform	-0.6	-1.0	-1.1	-1.3	-1.4	-5.5
Technical services and supplies	-0.3	-0.5	-0.6	-0.6	-0.7	-2.7
Other	0.1	0.1	0.1	0.2	0.2	0.7
Subtotal	-1.8	-2.8	-3.1	-3.5	-3.9	-15.1
Total	-5.1	-7.4	-9.4	-11.7	-14.2	-47.8
President's 1991 Budget as Estimated by CBO	99.8	112.6	125.6	139.7	154.6	

Proposed Policy Changes

Once again, the President's budget proposes significant cuts in the Medicare program--$5.1 billion in 1991, rising to $14.2 billion in 1995, and amounting to $47.8 billion over the five-year projection period. If

enacted, these proposals would reduce Medicare spending by about 7 percent over five years. About half of the proposed savings in Medicare would come from extensions of provisions that expire in 1990. Of the remaining proposed savings, about half would come from proposals that have been rejected by the Congress in the past and the remainder from a mix of new proposals and reductions in payments to providers that are similar to previously enacted changes.

The budget proposes to extend permanently several provisions of law that, in the past, have been enacted by the Congress for one or two years at a time. In total, these proposals would save $1.6 billion in 1991 and $20.8 billion over five years.

<u>Hospital Capital</u>. Beginning in 1987, the Congress has reduced capital payments to hospitals by increasingly larger percentages each year. For most of 1989 and 1990, the reduction was 15 percent of allowable capital-related costs. Starting in 1992, Medicare payments for inpatient hospital capital expenses will be made on a per case basis instead of the current reasonable cost reimbursement method. In fiscal year 1991, the President's budget proposes to reduce capital payments to urban hospitals by 25 percent, and capital payments to rural hospitals by 15 percent. These reductions would apply to both inpatient- and outpatient-related capital expenses, and would be permanent. Savings in 1991 would be $1.5 billion and would total $10.4 billion over five years.

<u>SMI Premiums</u>. Under current law, the Supplementary Medical Insurance (SMI) premium is set to cover 25 percent of program costs in 1990 and will increase by the Social Security cost-of-living adjustment (COLA) in future years. Since 1984, the SMI premium paid by beneficiaries for physician and other health services has been set to cover 25 percent of projected program costs. The President's budget proposes to set the premium permanently at the maximum of a rate that would cover 25 percent of program costs or the previous year's premium increased by the Social Security COLA, whichever is higher. Because program costs generally grow faster than the COLA, the premium under this proposal would usually be based on program costs. However, when the premium is calculated to cover a percentage of program costs, adjustments are made to allow for estimation errors and reserve requirements. When trust fund reserves are large, a cost-based premium will be set below the level actually needed to cover costs so that the

excess reserves are reduced. The SMI trust fund currently has large reserves. For this reason, estimates of a cost-based premium for the President's budget in 1991 are below the level of the COLA-adjusted premium. The estimated 1991 premium would be the COLA-adjusted premium, which is the same as the premium estimated under current law. Thus, there are no savings for this proposal in 1991, although it would save an estimated $9.8 billion over the 1992-1995 period.

New Physicians. In 1987, the Congress limited payments to physicians in their first year of practice to 80 percent of the amount that would otherwise be paid for a service. For 1990 only, this policy was expanded to limit payments to second-year physicians to 85 percent of what would otherwise be paid for a service. The budget proposes to make the 85 percent limit permanent and expand the policy further so that third-year physicians would be limited to 90 percent and so on. This proposal would also limit payments to health practitioners who are not physicians (for example, chiropractors, optometrists) in a similar manner. The proposal is estimated to save $55 million in 1991 and $595 million over five years.

Previously Rejected Proposals. Several proposals in the President's budget resemble proposals made in previous years but not enacted. These include reductions in payments to hospitals for indirect and direct medical education, across-the-board reductions in payments for outpatient hospital services, and a revision in the basis of payment for part of the durable medical equipment fee schedule that was enacted in 1987. In Chapter III, a revenue proposal that would make state and local employees eligible for Medicare is discussed. This proposal has been made for several years and would generate small increases in Medicare benefit payments if enacted. Savings from these proposals would be $1.7 billion, or 33 percent of total savings in 1991, and $12.0 billion or 25 percent of total savings over the five-year period.

Inflation-Related Updates. Over the past few years the Administration has proposed, and Congress has enacted, reductions in the automatic payment updates that hospitals, physicians, laboratories, and other suppliers receive to adjust for increased costs of providing services. This year, the President's budget proposes to reduce the hospital payment update, or market basket, by 1.5 percentage points, saving $0.6 billion in 1991 and $4.0 billion over five years. CBO projects that

the market basket will increase by 4.8 percent in 1991; the budget proposal would reduce this increase to 3.3 percent.

For physicians, the budget proposes to freeze payments for nonprimary care services at 1990 levels. Nonprimary care services such as radiology, surgery, and anesthesiology account for 83 percent of payments for physicians' services. The remaining 17 percent of payments are for primary care services such as office and nursing home visits. Payments for these services would increase at the rates allowed under current law. Most fees are increased annually by the growth in the Medicare economic index. CBO projects that this index will increase by 4.1 percent in 1991. The proposal would save $0.3 billion in 1991 and $3.0 billion over five years.

Laboratory services and durable medical equipment are reimbursed under regional fee schedules updated annually by the consumer price index. Different periods are used to calculate the increase for laboratories and durable medical equipment. CBO projects these indexes will increase at 4.4 percent and 3.6 percent, respectively, in 1991. The budget proposes to freeze payment levels for all services and supplies that are currently reimbursed at a level higher than the national median fee schedule amount. This freeze would save an estimated $0.1 billion in 1991 and $0.7 billion over five years. Overall, reductions in inflation-related updates would reduce spending by $1.0 billion in 1991 and by $7.6 billion, or 1.1 percent, over five years.

<u>Accelerated Transition to Physician Fee Reform</u>. In the Omnibus Reconciliation Act of 1989, the Congress enacted a major reform in the way Medicare pays for physicians' services. The major provisions of this reform will be phased in over five years starting in 1992. Physician fees will be paid on the basis of work performed and costs incurred in providing a service, and will take account of geographic differences in the costs of providing services. Many of the proposals related to physician payment in the President's budget can be characterized as accelerating the transition to this reform. The fee schedule would reallocate payments between specialties, types of service, and geographic areas--from those currently overpaid (based on the new fee schedule) to those currently underpaid. The budget would exempt underpaid services and providers from payment cuts, and reduce payments for currently overpaid services. This would have the effect of bringing payment levels closer together so that when the fee schedule is

implemented, the reallocation will be less dramatic. Proposals that speed up the transition would save $0.6 billion in 1991 and $5.5 billion over five years. This would reduce spending for physicians' services by about 3 percent over five years.

In the Reconciliation Act, the Congress reduced payments for certain services based on the difference between current payment levels and estimated payment levels under a fully implemented fee schedule. This provision eliminated one-third of this difference; the budget proposes to eliminate the remaining two-thirds of the difference between fully implemented fee schedule payment levels and current law payment levels. This proposal would affect about 20 percent of all payments for physicians' services and reduce spending by an estimated $120 million in 1991 and $1.1 billion over five years. The budget also proposes to reduce payments for services where the relationship between current payment levels is higher than the national average by more than can be explained by geographic differences in the cost of providing services. This proposal would only affect services that are not affected by other proposals in the budget. It would save $50 million in 1991 and $460 million over five years.

Radiology and anesthesia services as a whole appear to be overpriced relative to other services, based on the studies used to generate the physician fee schedule. These services account for about 15 percent of all payments to physicians. The budget proposes to reduce payments for these services by 10 percent. These two proposals would save $85 million in 1991 and $750 million over five years.

Three other proposals would reduce payments for services where more than one provider is involved and where there seems to be wide variation in medical practice. Payments for supervised anesthesia, assistants at surgery, and surgical global fees would be reduced. Anesthesiologists are paid at one rate if they perform a service personally and at lower rates if they are supervising certified registered nurse anesthetists (CRNAs). CRNAs are paid under a separately established fee schedule. The budget proposes to cap payments for supervised anesthesia at the amount that would be paid to an anesthesiologist personally performing a service. CRNA payments would be unaffected by this proposal; rather, the supervising anesthesiologist's payment would be limited to the difference between payment for personally performing a service and the CRNA payment

for providing the service. This proposal would save $80 million in 1991 and $725 million over the five-year period.

There is wide variation in the use of assistants at surgery. Currently, a physician who acts as an assistant at surgery receives 20 percent of the primary surgeon's payment. The budget proposes to eliminate extra payments for assistants at surgery; each surgery would be reimbursed at the same level whether an assistant was present or not. Exceptions would be made for certain procedures and special circumstances. The proposal would save an estimated $135 million in 1991 and $855 million over five years.

The budget would reduce surgical global fees by 2 percent. A global fee is a payment that includes the payment for the surgery as well as for associated services like postsurgical hospital visits. (A different reduction might be made if reliable data so warrant.) This proposal would save an estimated $40 million in 1991 and $365 million over five years.

Some facility payments to outpatient hospitals are based on payments to physicians, so that when payments to physicians are lowered, outpatient hospital payments are also reduced. The savings from all of the budget proposals affecting physician payments on outpatient hospital payments are estimated at $125 million in 1991 and $1.3 billion over five years.

Technical Services and Supplies. The budget proposes several changes in payment for technical services and supplies. Technical services are services that a physician does not routinely perform personally. The budget proposes to cap payments for these technical components of radiology and diagnostic services (other than laboratory services) at a national median payment amount. These proposals would save $70 million in 1991 and $600 million over five years. Similarly, the budget proposes to cap durable medical equipment payments at the national median, saving $110 million in 1991 and $1.0 billion over five years. Laboratory payments were capped at 93 percent of the national median in the 1989 Reconciliation Act and would be further reduced under the President's budget plan. Certain high-volume multiple lab tests would be capped at 80 percent of the median, while other less common procedures would be capped at 90 percent of the median. This

25-692 O - 90 - 6

proposal would save $50 million in 1991 and $465 million over five years.

In addition, the budget proposes to limit payments for certain other supplies and equipment. Rental payments under the durable medical equipment fee schedule would be limited to 120 percent of the purchase price for the item, rather than the 150 percent allowed under current law. This proposal would save $35 million in 1991 and $340 million over five years. Payments for oxygen would be reduced by 5 percent for estimated savings of $190 million over five years. Certain feeding supplies were not included in the original durable medical equipment fee schedule, and the budget proposes to include them for five-year savings of $75 million. Proposals to reduce payments for technical services and supplies are expected to save $0.3 billion in 1991 and $2.7 billion over five years.

Other. Miscellaneous proposals would increase Medicare spending by $130 million in 1991 and $690 million over the five-year period.

Most of the spending increase would result from a proposal to increase payments to health maintenance organizations (HMOs). Under current law, HMOs are paid 95 percent of the average Medicare benefit cost for Medicare beneficiaries not enrolled in HMOs. Payment rates for individual HMO enrollees are adjusted to reflect age, sex, geographic location, and other characteristics that are thought to affect health benefit costs. The budget proposes to increase this payment amount to 100 percent of average costs per Medicare beneficiary. This proposal would cost an estimated $190 million in 1991 and $1.5 billion over five years. In addition, the budget requests $145 million more for program research and administration over five years than projected in the CBO baseline.

Several miscellaneous proposals would reduce Medicare spending. The budget proposes to extend the period of required employer-based coverage for persons with end-stage renal disease (ESRD) from the current 12 months to 18 months. This proposal would save $45 million in 1991 and $270 million over five years. The budget also proposes to give Medicare carriers the authority to require that providers obtain permission to perform certain nonemergency services. This proposal would save $165 million over five years. Under current law, proprietary skilled nursing facilities are able to count return on equity for

their investors as part of the operating costs for which they are reimbursed by Medicare. The budget proposes to eliminate these payments, saving $205 million over five years. Previously, the Congress eliminated similar payments to hospitals. The Administration proposes to set a limit on the interns-and-residents-to-beds (IRB) ratio that is used to calculate the amount of the indirect teaching adjustment for PPS hospitals. Current (1989) levels would be a cap, and would discourage hospitals from closing beds in order to increase payments by increasing their IRB ratios. This proposal would save an estimated $240 million over five years. Altogether, the reductions from these miscellaneous proposals would save $0.9 million over five years, while the increases would add $1.6 billion over five years.

CBO Reestimates

CBO projects $1.0 billion less spending in 1990 than estimated in the budget, but $1.2 billion higher spending in 1991, rising to $5.6 billion in 1995. The lower 1990 estimate results mostly from different estimates of the effects of the Reconciliation Act on SMI spending, and partly from different expectations about program growth in 1990. Although the President's Medicare estimates are lower overall than CBO's, projections of the market basket update for hospital services and the MEI increase for physician services are higher than CBO's. These updates are heavily weighted toward wage growth. The Administration's projections of wage growth are significantly higher than those of the CBO. If the Administration's updates were used, the CBO baseline would be higher by $0.3 billion in 1991 and $1.2 billion by 1995. Most of this difference occurs in the Hospital Insurance (HI) program.

The remaining difference results mostly from technical differences in the estimates of the Hospital Insurance (HI) program. Two major differences are notable. First, CBO uses a significantly different assumption about case-mix index (CMI) growth for Prospective Payment System (PPS) hospitals than does the Administration. Second, CBO assumes that covered days in skilled nursing facilities (SNFs) paid by Medicare will be higher than does the Administration.

With regard to CMI growth, CBO assumes that the index will grow 2.5 percent in 1991 and the rate of growth of the index will decline

steadily to a 1.2 percent rate by 1995. The Administration assumes CMI growth to be constant at 1.0 percent per year over the projection period. The Prospective Payment Assessment Commission estimates that CMI growth in 1989 was 2.9 percent. Previously, CMI growth has been lower than 2.9 percent only in 1986 and 1987, when it was 2.8 percent and 2.6 percent, respectively. These different assumptions generate a difference of about $0.6 billion in 1991 estimates of PPS hospital payments, and about $2.8 billion by 1995.

The CBO estimates of reimbursements for SNFs are $0.8 billion above the Administration's in 1990, rising to $2.0 billion in 1995. Medicare reimbursements for SNFs rose rapidly from January to

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	96.6	98.6	110.1	121.9	135.0	149.1
CBO Reestimates						
Economic						
Hospital Insurance	0	-0.4	-0.8	-1.0	-1.1	-0.9
Supplementary Medical Insurance	0	0.1	a	a	-0.1	a
Premiums	0	0.0	a	a	-0.1	-0.2
Subtotal	0	-0.3	-0.8	-1.1	-1.3	-1.2
Technical						
Hospital Insurance	0.1	1.6	2.7	3.8	4.7	5.5
Supplementary Medical Insurance	-1.1	a	0.5	0.9	1.1	1.0
Premiums	a	a	0.1	0.1	0.1	0.3
Subtotal	-1.0	1.5	3.2	4.8	5.9	6.7
Total	-1.0	1.2	2.5	3.7	4.6	5.6
President's 1991 Budget as Estimated by CBO	95.6	99.8	112.6	125.6	139.7	154.6

a. Less than $50 million.

December 1988, apparently as a result of a new SNF instruction manual developed by the Health Care Financing Administration and several court decisions liberalizing the benefit. In January 1989, the SNF benefit was significantly enhanced by provisions of the Medicare Catastrophic Coverage Act of 1988 (MCCA). Medicare SNF reimbursements skyrocketed as the new benefit began. Late in 1989, the new SNF benefit was repealed effective January 1, 1990. CBO's current estimates assume that the events of 1988 and the increased SNF visibility resulting from MCCA will propel future reimbursements to higher levels than those anticipated by the Administration.

Most of the technical reestimates in SMI stem from lower estimated savings for the budget proposals. About half of these differences result from a miscalculation the Administration made of the savings from the physician fee freeze. The Administration has indicated that an alternative proposal to replace the lost savings will be forthcoming.

FUNCTION 600: INCOME SECURITY

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	156.8	163.6	171.7	181.5	188.8	
Proposed Changes						
Civil Service Retirement	-2.1	-3.2	-3.6	-4.0	-4.4	-17.2
Military Retirement	-0.6	-1.1	-1.4	-1.7	-2.1	-6.8
Housing programs	0.2	1.2	2.0	2.9	3.7	9.9
Nutrition programs	-0.8	-1.1	-1.3	-1.4	-1.3	-5.9
Low-income energy assistance	-0.4	-0.5	-0.5	-0.6	-0.6	-2.5
Trade Adjustment Assistance	-0.1	-0.1	-0.1	-0.1	-0.2	-0.7
Family support payments	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
Other	0.3	0.2	0.2	0.1	0.1	0.9
Total	-3.6	-4.7	-4.7	-4.9	-4.9	-22.8
President's 1991 Budget as Estimated by CBO	153.1	158.9	167.0	176.6	184.0	

Proposed Policy Changes

The President has proposed net reductions of almost $23 billion in income security programs over five years. If enacted, these proposals would lower outlays 3 percent below CBO baseline projections for the 1991-1995 period. The largest spending reductions--in civilian and military retirement, child nutrition, and low-income energy assistance programs--are identical or similar to changes requested in previous budgets. Major increases are proposed only in housing programs.

Civil Service and Military Retirement. The largest savings in income security programs would occur in the Civil Service and Military Retirement programs. Once again the Administration proposes to eliminate next year's cost-of-living adjustment (COLA) for nondisabled civil service and military retirees. In subsequent years, the Administration would limit COLAs for all civil service and military retirees to the in-

crease in the consumer price index (CPI) minus one percentage point, with lesser reductions if the CPI rises by less than 3 percent.

Based on an expected COLA of 4.1 percent in 1991, CBO estimates that eliminating the COLA would save $800 million in Civil Service Retirement and $600 million in Military Retirement in 1991. Savings from eliminating the 1991 COLA and reducing later COLAs would total $8.7 billion (civil service) and $6.8 billion (military) over the 1991-1995 period. The Administration assumes a 3.9 percent increase in 1991 and therefore estimates smaller savings from these COLA changes. (See function 650 for CBO and Administration COLA assumptions for 1992 through 1995.)

Under CBO economic assumptions, the COLA proposals would reduce benefits for military and civilian retirees by 7 percent below baseline levels in 1995. The last time the COLA was eliminated was in 1986 as a result of sequestration. Real benefits (adjusted for inflation) of federal retirees fell by 1.3 percent from that change.

The President's budget would also eliminate the option of a lump-sum payment in Civil Service Retirement. Under current law, civilian employees retiring from the federal government after September 30, 1990, may withdraw 100 percent of their contributions to the retirement system in the year they retire, with correspondingly lower annuitant payments in the future. CBO estimates that eliminating this option would save $8.5 billion over five years. The Administration estimates savings of $9.4 billion because it assumes larger lump-sum payments than CBO under current law. Because annuity payments are reduced for those electing a lump-sum distribution, eliminating the lump-sum option would eventually increase costs.

<u>Housing Assistance</u>. The President's budget would result in spending $9.9 billion above the CBO baseline for housing programs over the 1991-1995 period, largely for the Department of Housing and Urban Development's (HUD's) low-income rental assistance programs and for modernization of public housing projects. The 1991 appropriation request includes $15.1 billion for these programs, compared with the baseline level of $9.3 billion. This increase reflects the large number of existing rental assistance contracts that are expiring in the coming year. Of the 1991 funds, $7.7 billion would be used to renew expiring assistance contracts covering 294,500 rental units. (Only $1.1 billion

was needed in 1990 to renew expiring contracts.) Another $5.6 billion would provide assistance for an estimated 98,000 rental units, 75,000 of which could be receiving rental assistance for the first time. The remaining $1.8 billion would be for the modernization of existing public housing projects. Based on amounts appropriated in 1990, budget authority in the CBO baseline would provide only $1.1 billion to renew 41,000 expiring assistance contracts and $8.2 billion to assist about 88,000 rental units and to modernize public housing projects.

Outlays for these rental assistance and modernization programs under the President's budget proposal would exceed the baseline by $120 million in 1991 and by $7.5 billion over the five-year period. The CBO baseline, however, does not include enough funds to renew all expiring contracts. If sufficient authority were added to the CBO baseline to renew all expiring assistance contracts, as assumed in the HUD budget, the Administration's proposals could result in outlays that are $1.3 billion below the adjusted baseline over the five-year period.

As part of the HOPE initiative (Homeownership and Opportunity for People Everywhere), the President is requesting $250 million in 1991 for a new grant program. The bulk of this funding would be used to encourage tenant ownership in existing public housing and other HUD-subsidized projects. According to HUD, assistance for about 29,000 rental units will be used in 1991 to supplement the requested HOPE funding. The goal is to encourage low-income families to help manage the rental facility in which they live and eventually to own their units. The budget includes funding of $650 million for the new grant program in 1992 and $1 billion a year thereafter. This proposal would not add to 1991 outlays but would result in an estimated $1.9 billion in outlays over the five-year period.

The Administration is also proposing a new voucher program for rural housing. About $190 million in budget authority is requested for 1991 and a total of $1.5 billion for the 1991-1995 period. If funded, the program would add $2 million to outlays in 1991 and $473 million over the five-year period. This voucher program is intended as a partial substitute for the direct loan authority that would be reduced in function 370. The cuts requested in loan authority (function 370) would more than offset the additional costs (function 600).

Nutrition Programs. The largest savings for nutrition programs---netting $2.8 billion over five years--are proposed in the National School Lunch program. The Administration proposes to eliminate cash and commodity subsidies for school lunches served to children from families with incomes above 350 percent of the poverty level. In contrast to similar proposals in past years, children in families with incomes between 185 percent and 350 percent of the poverty level would be allowed to apply for continued lunch subsidies. The Administration also would increase lunch subsidies for children from families with incomes between 130 percent and 185 percent of poverty.

Eliminating lunch subsidies for children from families with incomes above 350 percent of poverty would save $1.1 billion over five years. CBO estimates that requiring children from families with incomes between 185 percent and 350 percent of poverty to apply for lunch subsidies would save an additional $1.9 billion because the majority of these children would probably not complete the newly required applications for a regular lunch subsidy (29 cents in 1991). Fewer than one-half of eligible children today complete applications for the larger reduced-price lunch subsidy ($1.33 in 1991). In addition, the CBO estimate includes savings of less than $0.3 billion, which results from schools leaving the National School Lunch program. The Administration shows much smaller savings ($1.3 billion over five years compared with CBO's $3.3 billion) because it assumes that all eligible children would apply for the regular lunch subsidies and that no schools would drop out of the program. Finally, increasing school lunch subsidies for children from families with incomes between 130 percent and 185 percent of poverty would cost an estimated $0.5 billion over five years. Of this estimate, $0.3 billion would be in direct costs for higher subsidies and $0.2 billion in costs for children who join the program as a result of the 20-cent reduction in lunch prices. The Administration's estimate does not include any costs associated with increased participation.

The Administration has modified a previously submitted budget request to institute a means test for subsidized meals in family day care homes. This year's budget proposes to reduce, rather than to eliminate, child care food subsidies for children from families with incomes above 185 percent of poverty, saving $1.7 billion over five years. Subsidies would be lowered for more than 70 percent of the children receiving subsidized meals in family day care homes.

The Administration also proposes spending $825 million in each year for a new Fiscal Assistance to Puerto Rico program. The current Nutrition Assistance to Puerto Rico program, funded at $937 million in 1990, would be eliminated. Because funding levels for the new program fall below the CBO baseline, outlays would fall $1.1 billion over the 1991-1995 period. In the Food Stamp program, policy changes include a cap on expenditures for employment and training and mandatory referral of certain recipients to Child Support Enforcement agencies, saving a total of $0.4 billion between 1991 and 1995.

Low-Income Home Energy Assistance. The Administration requests $1.05 billion for the Low Income Home Energy Assistance Program in 1991 and the same in subsequent years. This funding level is $0.3 billion below the 1990 appropriation and $0.4 billion below the CBO baseline for 1991. Five-year outlay savings relative to the CBO baseline total $2.5 billion, a reduction of 32 percent.

The Low Income Home Energy Assistance Program was first funded in 1981, received a peak appropriation of $2.1 billion in 1985, and has received declining funding levels since. The President's 1991 request is exactly half of the 1985 level.

Trade Adjustment Assistance. The President again proposes eliminating the Trade Adjustment Assistance program for workers who lose their jobs because of competition from foreign imports. The proposal would save an estimated $0.7 billion over the 1991-1995 period. These workers would be eligible for a new comprehensive program to provide training services for dislocated workers and other workers (see function 500). However, savings would result because the new Worker Readjustment program would not pay the cash benefits paid by the Trade Adjustment Assistance program.

Family Support Payments to States. The President's proposed savings are modest in the account that includes the Aid to Families with Dependent Children (AFDC) and the Child Support Enforcement (CSE) programs--an estimated $0.4 billion over five years. Changes in funding focus on CSE, for which federal and state government savings from collections of child support for AFDC families have fallen below costs for the first time since the CSE program was established in 1975. Moreover, states' net savings from the CSE program have continued to

grow--reaching about $370 million in 1989--while federal net costs have climbed to about $470 million. The President's major proposals--capping the federal match rate on CSE program expenditures and requiring states to charge higher fees for services to families able to pay--would reduce the federal government's share of costs and improve the overall program's cost effectiveness.

Other. The President's requests for administrative funds in unemployment compensation are above CBO baseline projections. This difference is partially offset by lower requests for administrative and research funds in the Family Support Administration and for general management of the Department of Health and Human Services. In addition, proposed funding levels for refugee assistance would be frozen at 1990 levels for five years, saving $0.2 billion from CBO baseline levels.

CBO Reestimates

CBO has reestimated the President's budget for income security programs downward by $0.3 billion in 1990 and upward by $2.6 billion in 1995. The CBO economic assumptions for higher COLAs, higher inflation, and higher unemployment rates lead to upward reestimates in all five years. These economic differences rise from $0.2 billion in 1990 to $3.2 billion in 1995.

The largest technical reestimate is in unemployment compensation. After adjusting for differences in economic assumptions, CBO's estimates for the unemployment compensation program are $0.6 billion below the Administration's estimates in 1990 and $1.3 billion below in 1995. CBO estimates that fewer people will receive benefits and that the average benefit will be lower. By 1995, CBO projects that 7.1 million people will receive an average weekly benefit of $186, while the Administration projects that 7.2 million people will receive an average weekly benefit of $205.

CBO's technical reestimate of the Supplemental Security Income (SSI) program decreases program outlays by a negligible amount in 1990 and raises them by $0.8 billion in 1995. Most of the SSI reestimate reflects different assumptions about the number of beneficiaries. CBO assumes that the number of aged SSI recipients will

decline less rapidly than is assumed in the Administration's estimate. In addition, CBO assumes that the number of blind and disabled recipients will increase at an average annual rate of 3.3 percent, while the Administration assumes an average annual growth rate of 2.4 percent.

CBO's estimate of benefit payments for AFDC--the major program in the Family Support Payments account--is $1.1 billion above the Administration's estimate in 1995. CBO projects both more AFDC families and higher average family benefits, with each projection accounting for roughly one-half of the reestimate. By 1995, CBO projects that 4.1 million families will be receiving AFDC, compared with 3.8 million in 1989, while the Administration projects a rise to 3.9 million families. For average benefits, CBO projects an annual growth of about 3 percent, roughly in line with recent growth in benefits, while the Administration projects an annual growth of about 2 percent.

CBO has also reestimated 1995 spending downward by $0.2 billion for two new programs in the Family Support Payments account. These new programs of child care assistance for current and former AFDC beneficiaries are just now taking effect, and little will be known about actual spending levels for at least another year. The major source of the estimating difference is that CBO expects state spending on the new Job Opportunities and Basic Skills Training Program (JOBS) to be significantly lower than does the Administration, thus reducing the demand for child care by participants in the JOBS program.

CBO's reestimate of JOBS reduces spending by $0.2 billion to $0.3 billion each year over the 1991-1995 period. The JOBS program for AFDC beneficiaries, enacted in the Family Support Act of 1988, must be implemented by the states no later than October 1, 1990. Federal funds are provided through a capped entitlement, which rises from $1.0 billion in 1991 to $1.3 billion in 1995, and are allotted to the states according to each state's share of adult AFDC beneficiaries. States must match the federal funds at various rates, ranging from 10 percent to 50 percent. The Administration is assuming that all states will fully use their allotments of federal funds. Based on 1990 spending estimates by the states and on discussions with officials in several states, CBO is assuming that some states will not have sufficient state funds to allow them to use their full federal allotments. On average, CBO

estimates that 65 percent of the 1991 federal funds for all states will be used, rising to about 80 percent in 1995.

CBO's outlay estimates for the Pension Benefit Guaranty Corporation (PBGC) differ from the Administration's estimates by $0.4 billion in 1990 and by $0.2 billion each year over the 1991-1995 period. This difference in estimates reflects uncertainty over the pension benefits of the LTV Corporation. The Supreme Court has agreed to hear arguments to decide whether the PBGC should continue to pay LTV's pension benefits or whether LTV should resume responsibility for the payments. While CBO's estimates assume that PBGC will continue to

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	146.6	153.7	159.6	166.3	174.6	181.4
CBO Reestimates						
Economic						
Cost-of-living adjustments	a	0.1	0.2	0.5	1.1	2.0
Other	0.2	0.5	0.6	0.9	1.1	1.2
Subtotal	0.2	0.6	0.8	1.5	2.2	3.2
Technical						
Unemployment	-0.6	-0.8	-1.0	-1.1	-1.2	-1.3
Supplemental Security Income	a	0.2	0.3	0.5	0.9	0.8
Family Support Payments	-0.1	0.2	0.3	0.5	0.7	0.9
JOBS	a	-0.3	-0.2	-0.2	-0.3	-0.3
Child nutrition	-0.1	-0.3	-0.4	-0.4	-0.4	-0.5
Other	0.4	-0.2	-0.6	-0.1	0.1	-0.1
Subtotal	-0.5	-1.2	-1.5	-0.8	-0.2	-0.6
Total	-0.3	-0.6	-0.7	0.7	2.0	2.6
President's 1991 Budget as Estimated by CBO	146.3	153.1	158.9	167.0	176.6	184.0

a. Less than $50 million.

pay LTV benefits, as is currently the case, the Administration's estimates assume LTV will resume responsibility for the payments.

Reestimates in outlays for child nutrition programs result from the differences in CBO's and the Administration's estimates of proposed policy changes, discussed above. Remaining differences in estimates include negative reestimates in Civil Service and Food Stamp programs, positive reestimates in the Military Retirement program, and both positive and negative reestimates in housing programs.

FUNCTION 650: SOCIAL SECURITY

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	265.8	282.7	300.4	318.6	337.6	
Proposed Changes	a	-0.1	-0.1	-0.2	-0.2	-0.6
President's 1991 Budget as Estimated by CBO	265.8	282.6	300.3	318.4	337.4	

a. Less than $50 million.

Proposed Policy Changes

The Administration proposes several relatively small changes in Social Security benefits payments, as well as an 8.6 percent increase in the limitation on administrative expenses (LAE) for the Social Security Administration in 1991. Projected increases in the LAE for the 1992-1995 period, however, fall short of maintaining administrative services at the 1991 level. The budget also includes several revenue proposals affecting Social Security, which are discussed in Chapter III. Relative to the CBO baseline, the proposed budget would save about $0.6 billion over the next five years, with about 70 percent of the savings attributable to administrative costs.

The Administration proposes to create new federal accounting procedures in 1993. These procedures would extend indefinitely the requirements of the Balanced Budget Act rather than let them expire after 1993 as under current law, and would create a new bookkeeping entry--the Social Security Integrity and Debt Retirement Fund. The Administration asserts that these measures will ensure that the large and growing surpluses in Social Security are used to help the economy meet the increased costs of paying for the retirement of the baby-boom generation. In fact, however, this change would mask the requirement that the federal government run an overall surplus.

The new accounting entry or "fund," which would be displayed as a new mandatory outlay from the general fund, would be related to the size of the anticipated Social Security trust fund surpluses and, according to the Administration's published descriptions, would be used to retire outstanding federal debt held by the public. If the overall budget were in surplus, as the Administration expects it to be after 1993, this proposal in essence suggests a change in federal accounting that would treat some monies used to retire debt as spending (the mandatory payments to this new "fund") and others as merely an entry in the means-of-financing statements. Because it does not follow standard accounting practices, this proposal is not reflected in CBO's reestimates of the President's 1991 budget.

CBO Reestimates

CBO has reestimated the President's budget request upward by a total of $15 billion from 1991 through 1995. CBO's projection of higher inflation and the resulting higher cost-of-living adjustments (COLAs) for Social Security accounts for $14.3 billion of the reestimates, with technical reestimates amounting to $0.7 billion. The CBO estimates of COLAs average about 0.5 percentage points more than the Administration's over the next five years, with the largest difference occurring in 1994 and 1995 (see table below).

Social Security Cost-of-Living Adjustments
Assumed by CBO and the Administration
(In percent)

	1991	1992	1993	1994	1995
CBO	4.1	4.3	4.3	4.3	4.3
Administration	3.9	4.1	3.8	3.6	3.3

CBO's technical reestimates increase spending each year through 1993, but reduce spending thereafter. In general, CBO projects a slightly faster growth in the number of Social Security recipients than does the Administration. However, by 1994, CBO's projections of average real benefits (that is, average benefits after adjusting for COLAs) are lower than the Administration's, probably because of less rapid real wage growth. CBO's lower projections for average real benefits

more than offset its larger caseload projections in 1994 and 1995. In addition, CBO projects that retroactive benefit payments will be growing less rapidly by the end of the five-year period.

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	248.8	264.8	280.9	297.7	314.6	331.4
CBO Reestimates						
Economic (Cost-of-living adjustments)	0	0.4	0.9	2.1	4.0	7.0
Technical						
Number of beneficiaries	a	a	0.2	0.3	0.4	0.7
Average benefits adjusted for inflation	0.1	0.5	0.5	0.2	-0.5	-1.4
Retroactive benefits adjusted for inflation	0.2	0.2	0.1	a	-0.1	-0.3
Other	a	a	0.1	a	a	0.1
Subtotal	0.4	0.6	0.8	0.5	-0.2	-1.0
Total	0.4	1.0	1.7	2.6	3.8	6.0
President's 1991 Budget as Estimated by CBO	248.8	265.8	282.6	300.3	318.4	337.4

a. Less than $50 million.

FUNCTION 700: VETERANS BENEFITS AND SERVICES

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	31.5	32.4	33.6	36.2	36.0	
Proposed Changes						
Pensions	a	-0.2	-0.2	-0.3	-0.3	-1.0
Medical care	0.2	0.2	0.2	0.1	a	0.8
Reimbursements, medical care	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Compensation	-0.1	-0.2	-0.2	-0.2	-0.2	-0.8
Guaranty and Indemnity Fund	-0.1	-0.1	-0.1	-0.2	-0.2	-0.6
Loan Guaranty Revolving Fund	-0.1	a	a	a	a	-0.1
All other	0.1	0.1	0.1	0.1	0.1	0.5
Total	-0.2	-0.2	-0.3	-0.5	-0.6	-1.9
President's 1991 Budget as Estimated by CBO	31.3	32.2	33.3	35.7	35.4	

a. Less than $50 million.

Proposed Policy Changes

The President's 1991 budget includes more than 20 legislative proposals for veterans' benefits and services. The combined effect of these proposals would reduce spending in function 700 by $1.9 billion through 1995 or by 1.1 percent.

Pensions. The President proposes to authorize the Department of Veterans Affairs (VA) to access Internal Revenue Service (IRS) data in order to verify the income reported by VA pensioners. Enacting this legislation before the end of fiscal year 1990 would reduce outlays by nearly $1.0 billion over the next five years. These savings would be partially offset by an estimated $0.2 billion in higher administrative costs in the general operating expenses account. Other proposed legislation would extend the period during which a pensioner could remain

in a VA nursing home or domiciliary before having his or her pension reduced. This provision is expected to cost $7 million to $8 million a year.

Medical Care and Reimbursements. The Administration's requested appropriation for VA medical care exceeds CBO's baseline budget authority by more than $800 million over the next five years. In addition, certain legislative proposals in the President's budget would further increase spending. The President proposes to reform the nurses' pay system and to increase the special pay for physicians and dentists. Because the proposed pay structures are not yet available from the VA, CBO is unable to estimate the cost of the pay proposals. The Administration has estimated that the two proposals combined would cost $70 million per year. A number of minor changes proposed in the outpatient dental program would increase costs by an estimated $19 million over the next five years.

These increases would be partially offset by savings from two measures to increase reimbursements for medical care. The 1991 budget proposes to institute copayments for veterans in the middle-income category who receive inpatient care, outpatient care, or prescription drugs, and to increase such copayments for veterans in the higher-income category. This proposal would decrease medical care outlays by about $300 million over five years by reducing the demand for care, and would increase copayment receipts over the same period by nearly $150 million. Another provision would authorize the VA to bill health insurers for the treatment of non-service-connected conditions of veterans who have service-connected disabilities. This proposal would increase reimbursements by an estimated $475 million over the next five years.

Compensation. The compensation program is not indexed by law. Historically, its benefits have been increased for inflation each year through legislation. The President's budget proposes to index the benefits permanently. Because the CBO baseline includes these out-year inflation increases as specified in the Balanced Budget Act, this proposal has no cost relative to the baseline. A proposal to discontinue compensation benefits to incompetent veterans (veterans who lack the mental capacity to contract or to manage their own affairs) who have no dependents and who have assets of $25,000 or more would reduce

outlays by nearly $800 million between 1991 and 1995. Approximately 14,000 veterans would lose benefits.

Veterans' Housing. The President proposes several changes in VA housing programs, which would reduce net outlays by $0.7 billion over the next five years. One measure would increase the origination fee on all newly guaranteed loans to 1.75 percent of the mortgage principal, regardless of the size of down payment. Currently, veterans making down payments of 5 percent or more pay lower origination fees than the 1.25 percent charged for no-down-payment loans. This change would reduce net outlays by around $100 million a year. New guarantees would be further restricted by the requirement of a 4 percent down payment on loan amounts over $25,000. The resulting declines in loan originations, default rates, and the cost of claim terminations would reduce outlays by $80 million over five years.

Another proposal would change the calculation by which the VA determines its most cost-effective course of action in response to a default on a guaranteed loan. This proposal would increase the number of foreclosures in which the VA pays off the guaranty instead of reimbursing the lender's loss and acquiring the securing property. Outlays would decline by approximately $170 million over five years.

CBO Reestimates

CBO estimates for the compensation and pensions accounts exceed those of the Administration by $23 million in 1991, growing to $408 million in 1995, because CBO's economic assumptions indicate higher cost-of-living adjustments than are shown in the budget. In addition, CBO projects a much slower decline in the disability compensation caseload than the VA, and a slower decrease in real average pension benefits. Finally, large differences in projected benefit payments for 1993 through 1995 result from a technical error in the budget regarding the number of payments per fiscal year. The first day of fiscal years 1995 and 1996 falls on a weekend. Under these circumstances, the VA is expected to mail the October compensation and pension checks so that they will arrive on the Friday before October 1. Doing so would result in 13 payments being made in fiscal year 1994 and 11 payments in 1996. The President's budget, however, assumes 13 payments in 1993 and 11 payments in 1995. As a result, the budget

assumes one more month of benefits in 1993 than CBO and one less in 1994 and 1995 (see table below).

Number of Assumed Benefit Payments Per Fiscal Year

	1991	1992	1993	1994	1995	1991-1995
CBO	12	12	12	13	12	61
Administration	12	12	13	12	11	60

The budget also projects that reimbursements for medical care from veterans and health insurers will rise from $119 million in 1990 to more than $400 million in 1991 and to more than $800 million by

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	28.9	30.3	31.0	33.3	32.6	31.7
CBO Reestimates						
Economic (Cost-of-living adjustments)	0.0	a	0.1	0.1	0.3	0.4
Technical						
Compensation and pensions	0.1	0.4	0.6	-0.7	2.2	2.6
Reimbursements for medical care	a	0.3	0.4	0.5	0.6	0.6
Other	a	0.3	0.2	a	-0.1	a
Subtotal	0.1	1.0	1.2	-0.1	2.8	3.3
Total	0.1	1.0	1.2	a	3.1	3.7
President's 1991 Budget as Estimated by CBO	29.0	31.3	32.2	33.3	35.7	35.4

a. Less than $50 million.

1995. The budget, however, offers no plan to accomplish this increase. The CBO estimate, which shows $2.5 billion less in receipts, assumes a continuation of recent trends.

FUNCTION 750: ADMINISTRATION OF JUSTICE

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	12.6	13.9	14.6	15.2	15.8	
Proposed Changes						
Customs user fees	-0.7	-0.8	-0.8	-0.8	-0.8	-3.7
Law enforcement programs	0.2	0.3	0.2	0.1	a	0.7
The Judiciary	0.2	0.4	0.4	0.4	0.3	1.6
Federal prison system	a	-0.1	-0.1	-0.3	-0.3	-0.8
Other	0.1	0.1	a	a	-0.1	0.1
Total	-0.1	-0.2	-0.3	-0.6	-0.9	-2.1
President's 1991 Budget as Estimated by CBO	12.5	13.7	14.3	14.5	14.9	
President's 1991 Budget	12.6	13.9	14.2	14.3	14.6	
CBO Reestimates	-0.1	-0.2	0.1	0.2	0.3	

a. Less than $50 million.

Proposed Policy Changes

The President's proposals for administration of justice would result in net outlays that are $2.1 billion (3 percent) below the CBO baseline for the 1991-1995 period. This reduction results from the proposed extension of customs user fees, which would generate $3.7 billion in receipts over the five-year period. Excluding these fees, spending in this function would be $1.7 billion (2 percent) above the baseline.

Customs User Fees. The President's budget includes a proposal to extend and restructure customs user fees. This proposal would save $3.7 billion relative to the baseline through 1995 because the fees are currently scheduled to expire after 1990. The proposed restructuring, which is to be specified later, would convert the ad valorem portion of the fees to a transaction-based fee designed to cover the cost of the Cus-

toms Service's commercial activities. This restructuring would make the fees consistent with the General Agreement on Tariffs and Trade (GATT).

Law Enforcement Programs. Spending in 1991 for federal law enforcement activities would be $6.2 billion, which is $0.2 billion, or 4 percent, above the baseline. Outlays over the five-year period would be $0.7 billion, or 2 percent, above the baseline. Customs Service salaries and expenses would exceed the baseline by $0.6 billion over five years, reflecting direct spending from the additional customs user fee receipts. Other law enforcement spending would be slightly above the baseline over this period. Spending for organized crime drug enforcement would rise sharply, as the result of a funding increase from $215 million in 1990 to $330 million in 1991. Other programs with increased spending would include the Federal Bureau of Investigation and the Drug Enforcement Administration, while spending for the Immigration and Naturalization Service and the Bureau of Alcohol, Tobacco, and Firearms would be below the baseline.

The Judiciary. Spending by the Judiciary would be $1.6 billion, or 17 percent, above the baseline level from 1991 through 1995. The budget proposes major increases in spending authority for 1991 and 1992, and would increase spending at close to the baseline rate of growth in subsequent years. Budget authority for 1991 would total $2.1 billion, compared with $1.7 billion in 1990. Most of this increase would be for the courts of appeals, district courts, and other judicial services.

Federal Prison System. The President's proposals would reduce spending on the federal prison system by almost $800 million, or 6 percent, below the CBO baseline from 1991 through 1995. This results from spending below baseline levels for buildings and facilities but above the baseline for operating expenses. Funding for prisons in 1990 was much higher than usual because it included an additional $1 billion for prison construction provided in the emergency drug funding appropriation (Public Law 101-164). The baseline includes similar funding in future years, while the President proposes to reduce funding substantially. (The appropriation request for 1991 is $374 million, compared with $1.4 billion provided for 1990.) As a result, proposed spending for buildings and facilities would be more than $4.5 billion, or 65 percent, below the CBO baseline over the five-year period.

The budget also includes an increase in spending for salaries and expenses of almost $3.8 billion, or 57 percent, relative to the CBO baseline from 1991 through 1995. The largest increases in spending authority would occur after 1992. These increases are primarily to staff and operate new prisons.

Other. The President's budget would increase spending for other justice programs by $135 million relative to the CBO baseline from 1991 through 1995. Spending for U.S. Attorneys would be more than $300 million (11 percent) above the CBO baseline, while general legal activities, the U.S. Marshals Service, and support of U.S. prisoners in nonfederal institutions would also be targeted for significant increases. The President would hold budget authority for the Legal Services Corporation constant at the 1990 level, resulting in a reduction in spending of almost $200 million below the CBO baseline from 1991 through 1995. The President's proposed spending levels for justice assistance programs would also be below the baseline, by $250 million. This reduction is the result of the President's proposal to eliminate nearly all juvenile justice programs. The spending levels for other parts of the Office of Justice Programs, including the anti-drug abuse grants, would increase at roughly the same rate as the baseline.

CBO Reestimates

CBO estimates that spending under the Administration's policies would be slightly higher over the five-year period than estimated in the budget. In general, these reestimates result from small differences in estimated spending rates. CBO expects that receipts from customs user fees would be $50 million to $100 million per year lower than the Administration estimates, reflecting implementation of the free trade agreement between the United States and Canada.

FUNCTION 800: GENERAL GOVERNMENT

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	11.2	11.6	11.7	11.9	12.3	
Proposed Changes						
Government-sponsored enterprise fees	-0.1	-0.3	-0.7	-0.9	-1.1	-3.0
Federal Buildings Fund	0.2	0.4	0.6	0.6	0.6	2.5
Internal Revenue Service	0.2	0.4	0.5	0.5	0.6	2.2
Other	a	-0.1	-0.3	-0.3	-0.5	-1.2
Total	0.3	0.4	0.1	a	-0.4	0.4
President's 1991 Budget as Estimated by CBO	11.5	12.1	11.8	11.8	12.0	
President's 1991 Budget	11.3	11.9	11.7	11.6	11.7	
CBO Reestimates	0.2	0.1	0.1	0.2	0.3	

a. Less than $50 million.

Proposed Policy Changes

The Administration's proposal to increase spending on general government activities would raise outlays by $0.4 billion above the CBO baseline over the 1991-1995 period. Several programs would receive large increases in spending, but these increases would be offset in part by new general government receipts.

GSE Fees. The largest change relative to the CBO baseline would result from a proposal, similar to one in the 1990 and previous budgets, to levy an annual fee on debt and other securities issued by government-sponsored enterprises (GSEs) beginning in 1991. The affected agencies include the Federal National Mortgage Corporation (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Student Loan Marketing Association. The fee would start at 10 basis points in 1991, increasing to 20 basis points in 1992 and 30

basis points in 1993 and thereafter. Mortgage-backed securities issued by Fannie Mae and Freddie Mac would carry a fee of 5 basis points in 1991, 10 basis points in 1992, and 15 basis points each year thereafter. Together these fees would generate an estimated $3 billion in receipts over the next five years.

Federal Buildings Fund. The largest spending proposal is for the Federal Buildings Fund for leasing space and repairing buildings. The request would increase outlays by $2.5 billion above the baseline over the 1991-1995 period, mostly because of higher rental costs for leased property as a result of increases in the government's space needs and rising rental rates.

Internal Revenue Service Initiatives. The President's proposal to hire about 3,500 new employees for a variety of initiatives aimed at increasing revenue collections would raise outlays by $0.2 billion above the baseline in 1991. To continue these initiatives and to fund improvements in information systems over the next five years, the President would spend a total of $2.2 billion above baseline levels. Further details on these proposed initiatives and CBO's estimates of the revenues they would generate are provided in Chapter III.

Other. The budget also includes spending for the legislative branch that would exceed the baseline by $0.2 billion in 1991 and $0.6 billion over the five-year period. Offsetting this increase is a reduced request for payments to the District of Columbia, which would result in payments to the District that are $0.5 billion less than baseline levels over the next five years. Other proposed reductions in general government spending are largely intragovernmental and would not affect total federal spending. In addition, both the budget and the CBO baseline include 1991 outlays of $500 million for the first restitution payments to Japanese-American World War II internees; total costs are expected to be $1.3 billion over the 1991-1993 period.

Social Security Integrity and Debt Retirement Fund. Beginning in 1993, the President proposes to record a portion of expected Social Security surpluses as general government spending. This proposal, however, is just an accounting device that would have no substantive effect on the budget. For this reason, discussed further in Chapter I, CBO follows standard budgetary accounting rules and does not include these outlays in the spending totals.

CBO Reestimates

The budget assumes that ongoing efforts to identify and sell surplus federal property would raise about $0.8 billion over the next five years. Repeated efforts throughout the 1980s to sell property have fallen far short of their stated goals, and the lengthy process of declaring property to be surplus and then selling it indicates that an increase in the near future is unlikely. CBO therefore estimates that receipts from surplus property sales will remain at historical levels, and will net about $0.3 billion over five years. CBO's estimates of outlays for a number of other programs, primarily the Internal Revenue Service and claims and judgments, are based on historical spending patterns and are also higher than those in the budget.

FUNCTION 900: NET INTEREST

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	184.0	190.1	198.2	204.1	208.2	
Proposed Changes						
Net interest on the public debt	-1.2	-3.9	-7.4	-11.9	-17.9	-42.2
Other interest	0.1	0.2	0.5	0.6	0.9	2.3
Total	-1.1	-3.7	-6.9	-11.3	-17.0	-40.0
President's 1991 Budget as Estimated by CBO	182.9	186.5	191.3	192.8	191.2	

a. Less than $50 million.

Proposed Policy Changes

Net interest outlays cannot be controlled directly, but are fundamentally determined by the government's deficit and by interest rates. The Administration's spending and revenue proposals, if enacted, would lead to smaller deficits than contained in the CBO baseline projections, and reduce the government's need to borrow. Under the Administration's deficit reduction program, debt held by the public is $31 billion lower than in the baseline at the end of 1991, and nearly $300 billion lower at the end of 1995. The resulting savings in debt service costs climb from $1.2 billion in 1991 to $17.9 billion in 1995.

While net interest primarily represents the government's cost of financing its debt, a variety of other interest payments and collections are also included. In particular, this category of spending reflects interest income collected by the government from loans or similar transactions. Modest reductions in interest income would occur under the Administration's proposals. By curtailing certain loan programs, the President's program would lead to reductions in interest income of $0.1 billion in 1991 and $0.9 billion in 1995.

CBO Reestimates

Reestimates of the Administration's net interest spending total $3.1 billion in 1990, $9.9 billion in 1991, and $55.1 billion in 1995. These differences stem overwhelmingly from higher interest rates and higher deficits under the Administration's plan as reestimated by CBO.

CBO assumes higher interest rates and significantly greater outlays for interest payments on the public debt than does the Administration. Reestimates attributable to this source grow from $5.1 billion in 1991 (when CBO's short-term interest rate projections are 1.5 percentage points above the Administration's, and longer-term maturities are 0.7 percentage points higher) to $20.6 billion in 1995 (when the interest rate differentials are 1.4 percentage points and 1.8 percentage points, respectively). Contrasting interest rate assumptions lead to relatively small differences in other interest.

Technical estimating differences are much less significant than economic reestimates, but add increasing amounts to interest outlays through 1995. Technical reestimates to net interest on the public debt grow from $2.6 billion in 1991 to $4.7 billion in 1995. In keeping with recent Treasury practice, CBO assumes greater reliance on medium- and long-term securities (which typically carry higher interest rates than short-term securities); CBO also assumes that borrowing takes place somewhat earlier in the year. CBO's estimates also incorporate nearly $20 billion in matured debt, omitted by the Administration, that was outstanding at the end of fiscal year 1989 and had to be refinanced, leading CBO to estimate additional interest costs of $0.6 billion in 1990 and about $1.5 billion thereafter. In 1991, these upward reestimates are partially offset by CBO's lower projection (amounting to $650 million) of interest on certain savings bonds that become eligible for a special bonus payment.

Technical reestimates of other interest programs reduce outlays over the projection period. Outlays are lower by $2.7 billion in 1991, and by $1.1 billion in 1995. These reestimates primarily reflect interest receipts earned by the Federal Financing Bank on its loans to the Resolution Trust Corporation for working capital, a plan that became final after the President's budget was released and was not reflected in the Administration's estimates.

As explained in Chapter I, CBO believes that the Administration has greatly underestimated the deficits that would result from its budget proposals. CBO's reestimates of the deficit under the Administration's plan grow from $37 billion in 1990 to $122 billion in 1995, and total nearly $500 billion over the 1990-1995 period. Increased interest costs from the additional borrowing required to finance these higher deficits grow from $1.0 billion in 1990 to $31.1 billion in 1995.

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	175.6	173.0	163.5	157.0	147.8	136.1
CBO Reestimates						
Economic (Interest rates)						
Net interest on the public debt	-0.5	5.1	12.9	17.0	19.5	20.6
Other interest	a	-0.2	-0.1	a	a	-0.2
Subtotal	-0.5	4.8	12.8	17.1	19.5	20.4
Technical						
Net interest on the public debt	3.4	2.6	3.7	4.1	4.4	4.7
Other interest	-0.8	-2.7	-3.6	-2.8	-2.0	-1.1
Subtotal	2.6	-0.1	0.1	1.4	2.3	3.6
Debt Service						
Economic reestimates	a	1.0	4.0	9.1	15.9	23.5
Technical reestimates	1.0	4.3	6.1	6.8	7.4	7.6
Subtotal	1.0	5.3	10.1	15.9	23.3	31.1
Total	3.1	9.9	23.0	34.3	45.0	55.1
President's 1991 Budget as Estimated by CBO	178.7	182.9	186.5	191.3	192.8	191.2

a. Less than $50 million.

FUNCTION 920: ALLOWANCES

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	0	0	0	0	0	
Proposed Changes						
Employee health benefits reform	-0.9	-0.9	-1.0	-1.0	-1.1	-4.8
Reduced government mail rates	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1
Total	-1.1	-1.1	-1.2	-1.2	-1.3	-5.9
President's 1991 Budget as Estimated by CBO	1.1	1.1	1.2	1.2	1.3	
President's 1991 Budget	1.1	1.1	1.2	1.2	1.3	
CBO Reestimates	0	0	0	0	0	

Proposed Policy Changes

The allowances function contains savings for two Administration initiatives--federal health benefits for federal employees and reduced government mail rates. Savings would total $1.1 billion in 1991 and $5.9 billion over five years. Both initiatives would require reductions in agency appropriations if the savings are to be achieved.

Employee Health Benefits. Proposed changes to the Federal Employees Health Benefits plan (FEHB) would save $850 million in 1991 and $4.8 billion over five years relative to the CBO baseline. At the time the budget was prepared, the Administration had not reached agreement on a specific plan to achieve these savings. One possibility is that the Administration will again propose the "weighted average" method of determining the government's contribution to FEHB. Under this plan, the government's contribution would fall from 67 percent of total plan costs to 60 percent, while the employee's contribution would rise by compensating amounts. If appropriate adjustments were

made to agency appropriations, such a plan would save approximately the amounts included in the budget. The Administration reportedly is continuing to develop an alternative plan for federal employee health benefits, but no details are currently available.

Reduced Government Mail Rates. The President's budget again includes a proposal to establish reduced rates for government mail, resulting in savings of $0.2 billion in 1991 and of $1.1 billion over five years. To recover the lost payments from the government, the Postal Service would increase postal rates for nongovernment users or cut its expenses.

Davis-Bacon Act. The Administration has indicated its intention to submit legislation modifying the requirements of the Davis-Bacon Act, a law that regulates wage rates paid on construction contracts funded at least in part by the federal government. Though not included in the original budget submission, the proposal would raise the minimum contract size covered under the act from $2,000 to $250,000, and would allow employers to pay lesser-skilled workers lower wages than they pay to journeymen. If this proposal were enacted and the appropriations for federal construction activities were reduced accordingly, an estimated $0.2 billion in savings would accrue in 1991 and federal spending would be lowered by $2.5 billion over the next five years. (For more details, see Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options* (February 1990), pp. 319-320.)

25-692 O - 90 - 7

FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1991	1992	1993	1994	1995	Cumulative Five-Year Changes
CBO Baseline	-38.8	-40.9	-42.7	-45.2	-47.6	
Proposed Changes						
Lease of naval petroleum reserves[a]	-1.0	-0.4	-0.4	-0.1	-0.1	-2.0
Sale of power marketing administrations[a]	-0.1	-1.2	0	0	0	-1.3
Lease of Arctic National Wildlife Refuge	0	0	-1.6	b	-0.9	-2.5
Spectrum auction	-0.4	-0.4	0	0	0	-0.8
Unspecified asset sales	0	-1.6	-1.6	-1.6	-1.6	-6.4
Employer's share of employee retirement	-0.1	1.3	1.2	1.1	1.4	4.8
Total	-1.6	-2.3	-2.4	-0.6	-1.2	-8.2
President's 1991 Budget as Estimated by CBO	-40.4	-43.2	-45.1	-45.8	-48.8	

a. The receipts from the proposed lease of the naval petroleum reserves and the proposed sale of the Alaska and portions of the Southeastern power marketing administrations are shown in function 950. Outlays in function 270 would increase, relative to the baseline, after these proposed asset transactions, because the assets would no longer generate direct receipts to the government.

b. Less than $50 million.

Proposed Policy Changes

The budget includes measures for increasing undistributed offsetting receipts by $8.2 billion over the 1991-1995 period. The President proposes to sell the rights to oil and gas production at the naval petroleum reserves (NPRs), government interests in two of the five power marketing administrations (PMAs), and oil and gas exploration rights for the Arctic National Wildlife Refuge (ANWR). The budget also includes proposed fees for the rights to use communications frequencies and an allowance for unspecified asset sales in future years. Finally, a number of proposals would affect the amounts agencies contribute for employee retirement, which appear as receipts in this function.

Almost all of these proposals are similar or identical to ones in previous budgets.

Naval Petroleum Reserves. The President proposes to sell the rights to produce petroleum products at the government's Elk Hills and Teapot Dome oil fields through a long-term lease. The buyer(s) of these rights would pay the government a fixed bonus bid of $1 billion in 1991, and $0.4 billion in both 1992 and 1993. The government would also receive royalties on future production, at rates offered by the highest bidder(s). CBO estimates that the NPR royalties and bonus payments would total $2 billion over the 1991-1995 period. These receipts would be almost completely offset (in function 270) over five years by a loss of about $1.9 billion in net income from the direct government sale of NPR products. The government would forgo additional net income after 1995.

Sale of Power Marketing Administrations. The President proposes to sell the Alaska PMA, and the Georgia-Alabama system within the Southeastern PMA, at the end of 1991. CBO estimates, however, that only the Alaska PMA could be sold in 1991 and that proceeds from its sale would be about $85 million. The Georgia-Alabama system could be sold for an estimated $1.2 billion. The budget includes the proceeds from this sale in 1991, but CBO believes the sale of this larger system could not be completed until 1992. Potential receipts from selling the PMAs are very uncertain because of the unknown structure of the sale, differing values of these assets to prospective buyers, and the uncertain impact of the sale on federal tax revenues. PMA sales receipts would be partially offset by lost income (in function 270) of about $0.3 billion over the 1991-1995 period and by additional amounts after 1995.

Arctic National Wildlife Refuge. The President proposes opening the ANWR to exploration and drilling for oil and gas, with lease sales occurring in 1993 and 1995. CBO expects that bonus bid receipts from these sales would total $1.6 billion in 1993 and $0.9 billion in 1995.

Spectrum Auction. The President proposes to authorize the Federal Communications Commission (FCC) to assign six megahertz of the nonbroadcast spectrum through competitive bidding. The budget does not provide details of the proposal, but the Administration estimates that it would generate additional receipts of $2.3 billion in 1991 and

$1.1 billion in 1992. In contrast, CBO estimates spectrum fees of $375 million in both 1991 and 1992.

Unspecified Asset Sales. The budget assumes receipts of $1.6 billion per year from 1992 through 1995 from as yet unspecified asset sales.

Employer's Share of Employee Retirement. Agency contributions to employee retirement programs are intragovernmental payments that are paid out of individual program accounts and recorded as offsetting receipts in function 950. The President proposes four changes in these agency payments, for a net decrease in receipts of $4.8 billion over the 1991-1995 period. These changes are offset in agency spending accounts.

First, the President requests lower civilian and military pay raises than assumed in the baseline, and delays raises from October until January of each year. This proposal would decrease agency payments for retirement by $0.3 billion in 1991, and by $2.6 billion over the 1991-1995 period. Second, the President proposes to reduce the size of military forces in each year, thus reducing retirement contributions by the Department of Defense (DoD). Contributions would fall by $200 million in 1991, and by more than $2.5 billion over the 1991-1995 period.

Third, beginning in 1992, the President would limit civil service and military retirees' cost-of-living adjustments (COLAs) to the change in the consumer price index minus one percentage point. This change would reduce military retirement contributions, shown as receipts in this function, by $3.4 billion through 1995. (It has no effect on agencies' payments to civilian retirement funds, which have different funding procedures.) Finally, the budget includes increases in Postal Service employer contributions of approximately $600 million in 1991, and $3.6 billion over the 1991-1995 period. Postal Service contributions would increase from 7 percent of employees' salaries to 11.7 percent for 1991 through 1993, then to 14 percent for 1994 and 1995.

CBO Reestimates

CBO estimates that outlays in this function would be above the Administration's estimates by $3.2 billion in 1991 and by another $3.1

billion over the following four years. Reestimates of receipts from the spectrum auction and the sale of the Southeastern PMA account for most of the 1991 reestimate.

Spectrum Auction. The Administration projects receipts from the spectrum auction that are greater by $1.9 billion in 1991 and $0.8 billion in 1992 than those estimated by CBO. Any estimate of receipts from auctioning parts of the spectrum is uncertain because the FCC has never used competitive bidding to assign licenses. Also, it is likely that the FCC would have considerable discretion over a number of important factors, including (1) whether or not to use an auction for license assignment; (2) the types of services that would be allowed to bid; (3) the amount of spectrum that would be auctioned; and (4) the timetable for issuance of licenses and receipt of payments. Because of these uncertainties and because the budget does not provide details of the proposal, the range of potential receipts is very wide and could encompass the Administration's estimate. Nevertheless, CBO believes that there are many scenarios under which receipts could be much less than projected by the Administration and could in fact be zero in 1991. CBO's estimate reflects the likelihood that auction receipts would fall toward the lower end of the range.

CBO REESTIMATES OF PROPOSED SPENDING IN THE PRESIDENT'S BUDGET (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
President's 1991 Budget	-36.5	-43.6	-43.8	-46.2	-46.6	-49.5
CBO Reestimates						
Spectrum auction	0	1.9	0.8	0	0	0
Sale of Southeastern Power Marketing Administration	0	1.2	-1.2	0	0	0
Employer's share of employee retirement	0.1	0.3	1.2	1.1	1.1	0.9
Other	-0.3	-0.2	-0.2	-0.1	-0.3	-0.2
Total	-0.2	3.2	0.6	1.0	0.8	0.7
President's 1991 Budget as Estimated by CBO	-36.6	-40.4	-43.2	-45.1	-45.8	-48.8

25-692 O - 90 - 8

Sale of Southeastern PMA. While the Administration includes sale receipts in 1991, CBO believes that the sale will not be completed until 1992, because a sale as large and complex as Southeastern's Georgia-Alabama system would require significant further study and negotiations among several affected utilities and government agencies.

Employer's Share of Employee Retirement. The Administration makes no adjustment to the military retirement contribution for the proposal to limit retirees' COLAs. CBO estimates that this proposal would lower DoD's rate of contribution by over 5 percent in 1992, and would reduce total DoD payments by almost $3.4 billion over the 1992-1995 period. This difference accounts for most of the reestimate in employee retirement receipts.

Other. CBO estimates higher net receipts from leasing the ANWR, NPR, and Outer Continental Shelf, totaling about $1 billion more than the Administration's projections over the 1991-1995 period. These reestimates primarily reflect CBO's assumption of higher oil prices than were used in the President's budget.

APPENDIXES

APPENDIX A

BASELINE BUDGET PROJECTIONS

The CBO baseline is a neutral benchmark against which the budgetary impact of various proposals and options can be measured and evaluated. It is constructed according to rules specified in the Balanced Budget Act for projecting current taxing and spending policies into the future.

Table A-1 summarizes CBO's latest baseline projections. These are consistent with the economic assumptions discussed in Chapter II. Over the 1990-1995 period, they show revenues growing at about 6 percent a year, outlays increasing at less than 5 percent a year, and the deficit declining from $159 billion in 1990 to $110 billion in 1995.

REVISIONS IN THE CBO BASELINE

CBO issued its initial baseline projections for this year in the *Economic and Budget Outlook: Fiscal Years 1991-1995,* published in January 1990. Since that time, with additional information available from various sources and the release of the President's 1991 budget, CBO has updated its spending and revenue projections. With one significant exception, spending for the Resolution Trust Corporation (RTC), the changes are small. But the RTC change has a dramatic impact, particularly on the 1990 and 1991 deficits. This appendix will briefly identify the major revisions to the January baseline and then provide extensive detail on the updated projections of RTC activity.

The RTC is charged with the task of closing or selling hundreds of insolvent savings and loans. Until recently, there was no determination as to how the agency would obtain the large amounts of up-front cash necessary to resolve its cases. For this reason, both the President's budget and CBO's January baseline included relatively modest outlays for the RTC. (The budget request shows a total of $9.6 billion in 1990 and 1991; the January baseline, $18.9 billion.) It now appears

TABLE A-1. BASELINE BUDGET PROJECTIONS (By fiscal year)

	1990	1991	1992	1993	1994	1995
			In Billions of Dollars			
Revenues						
Individual income	490	528	564	602	641	682
Corporate income	102	111	116	120	126	134
Social insurance	388	412	437	465	495	526
Other	87	86	87	90	94	97
Total	1,067	1,137	1,204	1,277	1,355	1,438
Outlays						
National defense	297	307	318	328	345	355
Nondefense discretionary spending	206	220	229	237	245	254
Entitlements and other mandatory spending	604	648	654	711	751	804
Net interest	179	184	190	198	204	208
Offsetting receipts	-60	-60	-63	-66	-69	-73
Total	1,226	1,298	1,328	1,409	1,476	1,548
Deficit	159	161	124	132	121	110
Deficit Targets	100	64	28	0	a	a
Debt Held by the Public	2,344	2,504	2,627	2,758	2,878	2,988
			As a Percentage of GNP			
Revenues						
Individual income	9.0	9.1	9.1	9.1	9.1	9.1
Corporate income	1.9	1.9	1.9	1.8	1.8	1.8
Social insurance	7.1	7.1	7.1	7.1	7.1	7.0
Other	1.6	1.5	1.4	1.4	1.3	1.3
Total	19.6	19.6	19.5	19.4	19.3	19.3
Outlays						
National defense	5.4	5.3	5.1	5.0	4.9	4.8
Nondefense discretionary spending	3.8	3.8	3.7	3.6	3.5	3.4
Entitlements and other mandatory spending	11.1	11.2	10.6	10.8	10.7	10.8
Net interest	3.3	3.2	3.1	3.0	2.9	2.8
Offsetting receipts	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0
Total	22.5	22.4	21.5	21.4	21.1	20.7
Deficit	2.9	2.8	2.0	2.0	1.7	1.5
Debt Held by the Public	43.0	43.2	42.5	41.9	41.1	40.0

SOURCE: Congressional Budget Office.

NOTE: The projections include Social Security, which is off-budget but is counted for purposes of the Balanced Budget Act targets. For comparability with the targets, the projections exclude the Postal Service, which is also off-budget.

a. The Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 established targets for 1988 through 1993.

that the RTC will meet its working capital needs by borrowing from the Federal Financing Bank (FFB), an arm of the Treasury. CBO therefore has revised its baseline projections to reflect such borrowing--currently estimated to total $55 billion by late 1991. While the borrowing itself does not affect the budget, spending of the borrowed amounts will count as budget outlays and increase the federal deficit. Some of this added spending will be offset by increased asset sales that will result from the higher case resolution activity. The net result is to add $19 billion to the 1990 baseline deficit and $26 billion to the red ink in 1991. Such sales will continue for many years, and baseline outlays after 1991 have been reduced by several billion dollars a year to reflect the added income. Table A-2 summarizes these and other major changes in the January baseline.

The other baseline revisions are much smaller--resulting in a $2 billion deficit increase for 1990, and $2 billion to $3 billion decreases over the next five years. Estimates of farm price support spending have been reduced by $1.3 billion in 1991 and by $0.6 billion in 1992 and 1993. Most of this change is based on recent Department

TABLE A-2. REVISIONS TO CBO BASELINE (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
January Baseline Deficit	138	138	135	141	130	118
Changes						
Resolution Trust Corporation	19	26	-10	-6	-5	-4
Farm price supports	a	-1	-1	-1	a	a
Medicare	1	-2	-1	-1	-2	-3
Other	1	1	a	-1	-1	-1
Total	21	23	-11	-9	-8	-7
February Baseline Deficit	159	161	124	132	121	110

SOURCE: Congressional Budget Office.

a. Less than $0.5 billion.

of Agriculture reports indicating smaller corn stocks and less acreage planted to wheat than previously thought. This is likely to cause higher grain prices and lower deficiency payments to farmers over the next few years than projected earlier.

Estimates of Medicare spending have been increased by $1 billion in 1990, and reduced by $1 billion to $3 billion a year from 1991 through 1995. Most of the baseline revisions for 1990 and 1991 reflect an announced Administration plan to speed up the payment of Medicare claims in fiscal year 1990 and slow them back to current rates in fiscal year 1991 and beyond. This timing shift increases estimated 1990 outlays by $1.5 billion and reduces 1991 outlays by the same amount. Because CBO practice is to include the effects of administrative actions in its projections, this timing shift is incorporated in the baseline. The plan, however, is clearly a budget gimmick. By simply shifting payments from one fiscal year to another, it will not contribute to meaningful deficit reduction. About two-thirds of the Medicare baseline reestimates for 1992 through 1995 stem from lower estimates of spending for the Supplementary Medical Insurance program. Other revisions involve a wide variety of spending programs and are small in the aggregate. Reestimates of revenues are minor.

The baseline does not incorporate the deferral of funds appropriated for certain defense programs in 1990. Although the Administration has announced its desire to defer $2.2 billion in defense appropriations, the deferrals may not remain in place for the entire year. As discussed in Box IV-1, GAO has questioned the legality of the deferrals, and the Administration may choose to withdraw some or all of them.

CBO'S BASELINE PROJECTIONS OF RTC SPENDING

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), enacted in August 1989, established the mechanisms for dealing with the savings and loan crisis. The Federal Deposit Insurance Corporation (FDIC), through the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund, is to complete the resolution of institutions sold before March 1989. The Resolution Trust Corporation (RTC) is to close or sell savings and loan institutions that are currently insolvent or expected to fail through August 1992,

and the new Savings Association Insurance Fund (SAIF) is responsible for dealing with problem thrifts after that date.

The legislation provided the RTC with $50 billion to close or subsidize the sale of hundreds of insolvent thrift institutions--$18.8 billion from the Treasury, $1.2 billion from the Federal Home Loan Banks, and another $30 billion to be borrowed through the off-budget Resolution Funding Corporation (REFCORP) starting in 1990. The $50 billion was intended to pay for insurance losses that could never be recovered. In the process of resolving the problem thrifts, however, the RTC will need cash far in excess of the $50 billion authorized by FIRREA to finance the purchase of assets that will subsequently be sold. For example, if an institution has assets with a book value of $100 million and insured liabilities of $130 million, a liquidation could require the RTC to spend $130 million immediately in cash to pay off creditors. It is further possible that an amount less than the book value would be recovered in future years as assets were sold, say $70 million. In this example, up-front cash of $130 million would be necessary, even though the ultimate loss would be only $60 million. Theoretically, the use of working capital is temporary. But if recoveries from asset sales are less than initially estimated, some of the working capital may not be repaid and the government's ultimate losses will increase.

The need for working capital appears to be substantial. The Administration has indicated a range of $40 billion to $100 billion--because the least costly method of resolving many institutions is believed to be through liquidations or "clean-bank" transactions, which require the RTC to strip out bad assets and sell them separately. Such transactions require much more up-front cash than selling or merging the entire institution. RTC's authority to borrow working capital for this purpose is not unlimited, however. FIRREA effectively caps RTC's obligations so that its liabilities may not exceed its assets, with assets in receivership valued at 85 percent of their net realized value, an amount that cannot be known at the time and would have to be estimated. FIRREA does not specify the source of working capital or the form that the borrowing could take.

The Department of Justice recently clarified the legal authority of the RTC to raise working capital by borrowing from the Federal Financing Bank (FFB), and the RTC Oversight Board has announced

that the RTC will begin borrowing from the FFB very soon. Funds borrowed from the FFB will add to the federal deficit when spent. Another potential source of working capital is the RTC's $5 billion line of credit with the Treasury, although the RTC expects to use this source of funds primarily for emergency purposes. In addition, the RTC could use private markets to raise off-budget funding for insolvent thrifts to supplement its FFB borrowing, but this form of financing would be more costly and has limited usefulness.

Baseline Projections for the RTC

The budgetary impact of spending by the RTC is still highly uncertain, even for 1990 and 1991. Closing or selling hundreds of insolvent thrifts may involve potential swings of tens of billions of dollars from year to year, depending on a host of interrelated factors that are extremely difficult to predict, including:

- The number of institutions that the Office of Thrift Supervision will identify for the RTC caseload;

- The form of the resolutions, with liquidations requiring much larger cash expenditures up front than assisted acquisitions, but resulting in more cash income in subsequent years;

- The order in which cases are resolved: if institutions with larger losses are resolved first, there will be greater spending in initial years;

- The pace of resolutions, which has been slow to date;

- The form and timing of borrowing of working capital; and

- The timing and value of asset sales.

Also, the RTC could take steps that would increase or accelerate its use of working capital and affect the budget as well. For example, it could delay some or all of the REFCORP borrowing, thus shifting outlays from 1991 to 1990. Such a delay would also allow the RTC to borrow working capital equal to 100 percent of the unused REFCORP

borrowing authority, whereas if the REFCORP funds were used to purchase assets, borrowing for working capital would be limited to 85 percent of the value of the assets acquired. Also, it could overvalue some of its assets, thus allowing additional borrowing, and could seek Congressional approval, without statutory changes required, to make use of its legal authority to incur net obligations beyond $50 billion. (FIRREA technically allows the RTC to spend a net of $68.8 billion, though the higher figure was apparently unintended.)

Given these uncertainties and the volatile nature of spending for this purpose, a number of assumptions had to be made in updating the CBO baseline to include the RTC's use of working capital. The baseline assumes that $24 billion will be borrowed from the FFB in 1990, and another $31 billion in 1991. Other critical assumptions are spelled out below. The net result is to increase CBO baseline projections for RTC outlays by $19 billion in 1990 and by $26 billion in 1991 from the January baseline levels (see Table A-3). Because this additional spending in 1990 and 1991 would permit the acquisition and subsequent sale of more assets, baseline outlays in later years are negative, and below previous estimates by a total of almost $25 billion over the 1992-1995 period.

The Baseline Compared with the President's Budget

The President's budget provides few details about the assumptions used to estimate spending for the RTC over the next five years, and several financial statements normally included are missing. In the President's 1991 budget request, the RTC uses only limited working capital, largely by spending previous appropriations and REFCORP funds for temporary lending to thrifts to replace funds borrowed at high interest rates. These loans are technically repaid and that cash is reused when the institution is finally closed. Proceeds from asset sales are also used for working capital.

The CBO reestimate of the President's budget is identical to the baseline, because no legislation is proposed in the budget. Thus, CBO's estimate of RTC outlays exceeds the estimates in the President's budget by about $31 billion in 1990 and $24 billion in 1991, but is lower by $13 billion in 1992 and 1993, $10 billion in 1994, and $7 billion by 1995

(see Table A-3). A more detailed discussion of the assumptions underlying the CBO baseline follows.

Baseline Assumptions

The CBO baseline assumes that the RTC will borrow from the FFB until it reaches the statutory cap on its outstanding obligations. However, there is some uncertainty about the amount of this cap. While it appears that the intent of the Congress was to limit the RTC to net spending of no more than $50 billion, the formula limiting RTC's obligations in FIRREA failed to include Treasury appropriations of $18.8 billion in 1989. Thus, FIRREA technically allows the RTC to spend a net of $68.8 billion. The Administration has indicated that it will honor the $50 billion ceiling, and the General Accounting Office, when calculating RTC's net cumulative losses, will assume that the $50 bil-

TABLE A-3. CBO AND ADMINISTRATION ESTIMATES OF RTC SPENDING (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
CBO February Baseline and Reestimate of the President's Budget	33.0	31.0	-13.0	-13.0	-10.0	-7.0
Change in CBO Baseline						
CBO January Baseline	14.0	4.9	-3.5	-6.9	-4.8	-3.3
Change in Baseline from January to February	19.0	26.1	-9.5	-6.1	-5.2	-3.7
Reestimate of President's Budget						
President's 1991 Budget	2.3	7.3	0	0	0	0
Difference Between President's 1991 Budget and February Baseline	30.7	23.7	13.0	13.0	10.0	7.0

SOURCES: Congressional Budget Office; Office of Management and Budget.

lion limitation applies. Consistent with this treatment, the CBO baseline assumes that the RTC will borrow as much as it can pay back from liquidating assets, while realizing net losses of no more than $50 billion over time.

A key to determining the amounts the RTC is likely to borrow are the expected proceeds from the sale of assets, which represent the second largest source of cash to the RTC. Estimating the pace and size of sale proceeds realized by the RTC is highly speculative, given that there is little historical precedent for sales of this magnitude, and given the competing goals of minimizing the losses to the federal government, minimizing the effects of disposal of assets on local economies, and generating sufficient cash for case resolutions. CBO's estimates assume that the RTC will recover an average of about 70 percent of the estimated value of assets at the time they are acquired. Collections are expected over an eight-year period after the assets are placed in receivership; more than 75 percent of the collections is expected in the first four years. CBO's caseload projections are based on RTC's priorities for selecting cases for resolution.

CBO estimates that the RTC could borrow about $55 billion in working capital and pay it back from asset sales over the next 10 years. During the 1990-1992 period, cash raised by the Resolution Funding Corporation ($30 billion), remaining 1989 Treasury contributions ($9 billion), asset sales ($37 billion), repayments of advances ($11 billion net), and FFB borrowing ($55 billion) would allow the RTC to spend about $120 billion on case assistance, and make interest ($8 billion) and principal ($13 billion) payments to the FFB (see Table A-4).

RTC's Additional Funding Needs

The $120 billion included in the baseline for RTC case resolutions for 1990 through 1992 is probably sufficient to resolve 250 to 350 insolvent institutions, but is almost certainly not enough to resolve the 500 to 600 institutions now in the RTC caseload or expected to join it during the next three years. Almost all of that spending is expected to occur before the end of 1991, when the RTC would run out of cash--both for insurance losses and for working capital. CBO now estimates that by 1992 the RTC will need at least an additional $25 billion to $30 billion for net losses, plus working capital of at least the same amount, in

order to resolve the entire inventory of 500 to 600 insolvent thrifts. This estimate does not include costs for additional thrifts that are likely to become insolvent in the next few years. Under current law, SAIF would have to handle cases that remain after the RTC authority to resolve cases ends in 1992.

The Budget Treatment of RTC Spending

The President's budget distinguishes between two types of working capital: "normal," which is repaid from asset sales within months, and

TABLE A-4. PROJECTED USES AND SOURCES OF RTC CASH, FISCAL YEARS 1990-1992 (In billions of dollars)

	1990	1991	1992
RTC Disbursements			
Case resolutions	62	55	3
Advances (loans) to thrifts	2	0	0
Interest payments to FFB	1	3	4
Principal payments to FFB	0	0	(13)
Total	65	58	20
RTC Sources of Cash			
REFCORP funding	19	11	0
Asset sales	4	14	19
Repayment of advances	9	3	1
Treasury appropriations	(9)	0	0
FFB borrowing	(24)	(31)	0
Total	65	58	20
Net Outlays	33	31	-13

SOURCE: Congressional Budget Office.

NOTE: Items in parentheses do not count toward the calculation of RTC's budget outlays. RTC principal repayments to the FFB are repayment of agency debt and do not add to the deficit. Treasury appropriations and proceeds from FFB borrowing are a means of financing agency spending and do not count as offsetting collections to the RTC or reduce outlays. RTC = Resolution Trust Corporation; FFB = Federal Financing Bank; REFCORP = Resolution Funding Corporation.

"extraordinary," which is repaid from asset sales over a long period of time. The normal working capital, which is included in the President's budget, is paid off within a fiscal year and has little impact on the deficit.

The President's budget makes a case for excluding the "extraordinary" working capital from the budget calculations used to determine sequestration amounts under the Balanced Budget Act. CBO agrees that such spending has no real economic effect. Moreover, the cash-based budget is ill suited for measuring the long-term impact on taxpayers of RTC's activities, which increase the deficit in early years while lowering it in later years when the proceeds from asset sales offset other government spending.

The Balanced Budget Act excludes asset sales from both the budget baseline and the calculation of budgetary savings--except for "routine, ongoing" asset sales or sales previously mandated by law. It is not clear whether RTC asset sales are covered by the exclusion; if they are, so that asset sales would not count as receipts, it would also make sense not to count RTC's expenditure of working capital to acquire the assets. Counting asset acquisitions but not sales against budget targets would overstate outlays over time and needlessly and inconsistently bias budget policy toward fiscal constraint. Nonetheless, the act contains no provision that would allow this difficulty to be resolved, and CBO believes that a statutory change would be required to exclude the spending of working capital from the deficit totals used for the Balanced Budget Act.

Indeed, a clear economic case exists for excluding from the act's baseline deficit calculation all of RTC's net expenditures except payment of interest on RTC's debt to the FFB. (Repayment of principal does not count as an outlay in any event.) This case is based on the fact that such spending does not change the government's balance sheet and does not affect national saving in the way that most federal spending does. The same case cannot be made for the interest on government borrowing, whether through the FFB, REFCORP, or the Treasury. (Table I-5 shows CBO's deficit estimates excluding noninterest outlays of the RTC.)

APPENDIX B

COMPARISON OF THE CBO AND ADMINISTRATION ECONOMIC FORECAST RECORDS

On average, the Congressional Budget Office's economic forecasts have been more accurate than the Administration's for the 11 forecasts made between 1978 and 1988. CBO's forecasts have been slightly better than the Administration's for the period that affects the accuracy of the estimates for the budget year deficit--that is, the two-year horizon--and have a larger edge over the longer horizon. None of the differences, however, is large enough to be significant in a statistical sense. In other words, the historical record alone cannot provide strong evidence regarding which forecast will do better in the future.

This appendix compares CBO forecasts with the corresponding forecasts of the Carter and Reagan Administrations. Forecasts issued early in 1978 through early 1988 are included. The Reagan/Bush forecast of early 1989 cannot be included because the budget year that was the subject of that forecast, the 1990 fiscal year, is not yet complete.

Three important summary measures of forecast performance are: the mean error, the mean absolute error, and the root mean square error.[1] The first measure, the simple average of all the errors, indicates the bias of the forecasts. In this measure, the underestimates and overestimates will offset each other, thereby showing whether the forecasts overestimate or underestimate on average. The second measure, the mean absolute error, indicates the average size of the overestimates and underestimates without regard to sign. The root mean square error also shows the size of the error without regard to sign, but it gives greater weight to larger errors.

A less important measure of forecast performance compares forecasts by the number of times one or the other was the more accurate of the two. Such rankings could be misleading, however, because they do

1. The mean absolute error is the average of all errors without regard to sign. Root mean square error is calculated by first taking the square of all errors, then taking the square root of the average of the squared errors.

not measure how much better each forecast was on average. For example, if one forecaster does only trivially better than another on numerous occasions but much worse in a few years, the ranking measure would improperly indicate that forecaster was the better of the two. Therefore, the forecast rankings mentioned below should be interpreted with caution.

This appendix considers two time periods. The time period of most interest for deficit forecasters is the two-year forecast horizon. Both the Administration and CBO publish forecasts in January or February for the budget year that begins in October of that year. An economic forecast that is accurate for both the months leading up to the budget year and the months of the budget year itself will provide the basis for an accurate forecast of the deficit. A second time period, a four-year horizon, is used to examine the accuracy of longer-term projections of real growth in gross national product.

THE TWO-YEAR FORECAST HORIZON

For the two-year forecast horizon, CBO has a better record for forecasting real GNP growth and the inflation-adjusted short-term interest rate. There was little difference, however, between the Administration and CBO in the accuracy of their forecasts of the inflation rate and the nominal short-term interest rate.

CBO's edge in forecasting real GNP growth gave it an advantage in forecasting the deficit, since real growth is the most important variable for minimizing errors in forecasting deficits. Forecasting inflation, nominal GNP growth, and nominal interest rates accurately is less important for deficit forecasting now than it was in the late 1970s and the early 1980s. Given current law and the current level of the national debt, higher inflation increases both revenues and outlays by similar amounts. Revenues increase because taxes are levied on nominal incomes, profits, and transactions. Outlays increase for two reasons: first, because various entitlement programs are indexed to infla-

tion, and second, because nominal interest rates increase, and therefore federal debt service increases when inflation rises.[2]

Real GNP Growth

CBO had a slightly better record than the Administration over the two-year horizon in forecasting real GNP growth, the single most important variable for forecasting the deficit (see Table B-1). CBO's average error, or bias, was a 0.1 percentage point overestimate and the Administration's was 0.4 percentage point. This slightly higher average error indicates a mild optimistic bias on the part of the Administration, but it is not large. The root mean square errors were 1.2 percentage points for CBO and 1.5 percentage points for the Administration. CBO's forecast was closer to the true value in seven of the eleven periods, the Administration forecast better in two, and the two forecasters had equal errors in two of the periods (see Table B-5).

The bulk of the difference between CBO's and the Administration's record is the result of the forecasts issued in January of 1981, 1982, and 1983. Although virtually all forecasters turned out to be too optimistic for 1981 and 1982, the Administration's forecasts in those years turned out to be particularly optimistic. In the January 1983 forecast, however, the reverse was true. The Administration's forecast had a large error on the low side. In recent years, the 1984 through 1988 forecasts, there was not a large difference in the accuracy of the two organizations' forecasts.

CPI Inflation

There is essentially no difference in the records for forecasting the average annual growth of the consumer price index over the two-year horizon (see Table B-2). Both organizations underestimated future inflation in their 1978, 1979, and 1980 forecasts, and both tended to overestimate inflation in their 1981 through 1986 forecasts. The

2. Rules of thumb for estimating the effect on the deficit of changes in various macroeconomic variables are given in *The Economic and Budget Outlook: Fiscal Years 1991-1995* (January 1990), p. 55.

TABLE B-1. COMPARISON OF CBO AND ADMINISTRATION TWO-YEAR FORECASTS OF REAL GNP GROWTH (By calendar year)

	Actual	CBO Forecast	CBO Error	Administration Forecast	Administration Error
1978-1979	3.9	3.9	0.0	4.7	0.8
1979-1980	1.1	2.6	1.5	2.9	1.8
1980-1981	0.9	0.5	-0.4	0.5	-0.4
1981-1982	-0.3	1.9	2.2	2.6	2.9
1982-1983	0.5	2.1	1.6	2.7	2.2
1983-1984	5.2	3.4	-1.8	2.6	-2.6
1984-1985	5.1	4.7	-0.4	4.7	-0.4
1985-1986	3.0	3.3	0.3	3.9	0.9
1986-1987	3.2	3.1	-0.1	3.7	0.5
1987-1988	4.0	2.9	-1.1	3.3	-0.7
1988-1989	3.6	2.4	-1.2	2.9	-0.7
Mean Error	n.a.	n.a.	0.1	n.a.	0.4
Mean Absolute Error	n.a.	n.a.	1.0	n.a.	1.3
Root Mean Square Error	n.a.	n.a.	1.2	n.a.	1.5

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Commerce, Bureau of Economic Analysis.

NOTES: Actual values are the two-year growth rates for real gross national product (GNP) currently reported by the Bureau of Economic Analysis, not the first reported values. Forecast values are for the average annual growth in GNP over a two-year period. The forecasts were issued in January of the initial year of the period. Errors are forecast values minus actuals; thus, a positive error is an overestimate.

n.a. = not applicable.

TABLE B-2. COMPARISON OF CBO AND ADMINISTRATION TWO-YEAR FORECASTS OF THE CPI INFLATION RATE (By calendar year)

	Actual		CBO		Administration	
	CPI-U	CPI-W	Forecast	Error	Forecast	Error
1978-1979	9.5	9.5	6.0	-3.5	6.0	-3.5
1979-1980	12.4	12.4	8.1	-4.3	7.4	-5.0
1980-1981	11.9	11.9	10.1	-1.8	10.5	-1.4
1981-1982	8.2	8.1	10.5	2.3	9.7	1.6
1982-1983	4.7	4.5	7.2	2.5	6.6	2.1
1983-1984	3.8	3.2	4.8	1.0	4.8	1.6
1984-1985	3.9	3.5	5.0	1.1	4.5	1.0
1985-1986	2.8	2.5	4.1	1.3	4.2	1.7
1986-1987	2.8	2.6	3.8	1.0	3.8	1.2
1987-1988	3.9	3.8	4.0	0.1	3.3	-0.5
1988-1989	4.4	4.4	4.7	0.3	4.2	-0.2
Mean Error	n.a.	n.a.	n.a.	0.0	n.a.	-0.1
Mean Absolute Error	n.a.	n.a.	n.a.	1.7	n.a.	1.8
Root Mean Square Error	n.a.	n.a.	n.a.	2.1	n.a.	2.2

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Labor, Bureau of Labor Statistics.

NOTES: Values are for the average annual growth of the consumer price index (CPI) over the two-year period. CBO forecast the CPI-U (for all urban consumers). The Administration forecast the CPI-W (for urban wage earners and clerical workers). The forecasts were issued in January of the initial year of the period. Errors are forecast values minus actuals; thus, a positive error is an overestimate.

n.a. = not applicable.

measures of bias and the size of the errors are virtually the same for CBO and the Administration. The Administration was closer to the true value in five of the eleven periods, CBO closer in five, and both had the same error for one period.

Nominal Short-Term Interest Rates

CBO's record is marginally better than the Administration's for nominal short-term interest rates over the two-year horizon (see Table B-3). The sizes of their errors were similar, but CBO had a smaller downward bias in forecasting interest rates than the Administration. CBO was closer to the true value in seven of the eleven periods, and the Administration was closer in four.

Inflation-Adjusted Short-Term Interest Rates

CBO had a better forecasting record for inflation-adjusted short-term interest rates. The inflation-adjusted rate used in this discussion is the three-month Treasury bill rate less the growth rate of the CPI. The growth of the CPI is measured as the average annual rate from the fourth quarter of the preceding year to the fourth quarter of the second year of the period. Since CBO had forecast the CPI-U, and the Administration the CPI-W, two actual inflation-adjusted interest rates are given in the table and used for analyzing forecast accuracy (see Table B-4).

CBO's errors were smaller than the Administration's for all of the measures. Both CBO and the Administration had an optimistic bias--that is, they forecast lower inflation-adjusted interest rates than have actually occurred on average--but the Administration's bias is greater. The Administration's mean absolute and root mean square errors were also larger, and CBO was closer to the actual value in nine of the eleven periods (see Table B-5).

Note that the optimistic biases are greater in the last nine years than indicated by the average of the entire period. Inflation-adjusted short-term interest rates were higher in the 1980s than in previous decades. Forecasters in general failed to anticipate this departure from historical norms.

TABLE B-3. COMPARISON OF CBO AND ADMINISTRATION TWO-YEAR FORECASTS OF NOMINAL SHORT-TERM INTEREST RATES (By calendar year)

	Actual	CBO		Administration	
		Forecast	Error	Forecast	Error
1978-1979	8.6	6.5	-2.1	6.1	-2.5
1979-1980	10.8	8.4	-2.4	8.2	-2.6
1980-1981	12.7	9.5	-3.2	9.8	-2.9
1981-1982	12.3	13.3	1.0	10.0	-2.3
1982-1983	9.6	12.6	3.0	11.1	1.5
1983-1984	9.1	7.1	-2.0	8.0	-1.1
1984-1985	8.5	8.8	0.3	8.1	-0.4
1985-1986	6.7	8.5	1.8	8.0	1.3
1986-1987	5.9	6.8	0.9	6.9	1.0
1987-1988	6.2	5.7	-0.5	5.5	-0.7
1988-1989	7.4	6.5	-0.9	5.3	-2.1
Mean Error	n.a.	n.a.	-0.4	n.a.	-1.0
Mean Absolute Error	n.a.	n.a.	1.6	n.a.	1.7
Root Mean Square Error	n.a.	n.a.	1.9	n.a.	1.9

SOURCES: Congressional Budget; Office of Management and Budget; Federal Reserve Board.

NOTES: Values are the average of the three-month Treasury bill rate for the two-year period. The forecasts were issued in January of the initial year of the period. Errors are forecast values minus actuals; thus, a positive error is an overestimate.

n.a. = not applicable.

TABLE B-4. COMPARISON OF CBO AND ADMINISTRATION TWO-YEAR FORECASTS OF THE INFLATION-ADJUSTED SHORT-TERM INTEREST RATE (By calendar year)

	Actual		CBO		Administration	
	Based on CPI-U	Based on CPI-W	Forecast	Error	Forecast	Error
1978-1979	-2.2	-2.3	0.5	2.7	0.0	2.3
1979-1980	-1.9	-1.9	0.5	2.4	1.3	3.2
1980-1981	1.6	1.8	0.0	-1.6	0.1	-1.7
1981-1982	5.3	5.4	3.5	-1.8	1.2	-4.2
1982-1983	5.7	6.0	5.8	0.1	6.2	0.2
1983-1984	5.4	5.9	2.3	-3.1	3.3	-2.6
1984-1985	4.7	5.1	3.8	-0.9	3.6	-1.5
1985-1986	4.3	4.6	4.3	0.0	3.7	-0.9
1986-1987	3.0	3.2	2.8	-0.2	2.9	-0.3
1987-1988	1.8	1.8	1.3	-0.5	1.0	-0.8
1988-1989	2.9	3.0	2.2	-0.7	1.2	-1.8
Mean Error	n.a.	n.a.	n.a.	-0.3	n.a.	-0.7
Mean Absolute Error	n.a.	n.a.	n.a.	1.3	n.a.	1.8
Root Mean Square Error	n.a.	n.a.	n.a.	1.7	n.a.	2.1

SOURCES: Congressional Budget Office; Office of Management and Budget; Federal Reserve Board; Department of Labor, Bureau of Labor Statistics.

NOTES: Values are for the three-month Treasury bill rate less the respective forecast for inflation as measured by the change in the consumer price index (CPI). CBO forecast the CPI-U (for all urban consumers). The Administration forecast the CPI-W (for urban wage earners and clerical workers). The change in the CPI for the two-year periods is measured as the average annual rate from the fourth quarter of the preceding year to the fourth quarter of the second year of the period. The forecasts were issued in January of the initial year of the period. Errors are forecast values minus actuals; thus, a positive error is an overestimate.

n.a. = not applicable.

THE LONGER HORIZON

The Administration's errors for real GNP growth for the longer horizon, measured here as four years ahead, were larger than CBO's. Although this does not directly affect the estimates of the budget year deficit, accuracy in the longer term is obviously important for multiyear budget planning. It should be noted that neither the Administration nor CBO considers its projections to be its best guess about the year-to-year course of the economy for those years. The Administration indicates that its projection is based on the adoption of the President's budget, and CBO in recent years has considered its projections an indication of the average future performance of the economy if major historical trends prevail. Neither attempts to forecast any cyclical fluctuations in the projection period.

In the few years that are available for comparison, the Administration's projections had an upward bias of 1.1 percentage points for the average annual rate of real GNP growth over four-year periods, and CBO had an upward bias of 0.7 percentage point (see Table B-6). The biases was largely the result of the inability of the projections made in January of 1978, 1979, and 1980 to anticipate the recessions of

TABLE B-5. RANKING OF CBO AND ADMINISTRATION TWO-YEAR FORECASTS, CALENDAR YEARS 1978-1988

	Number of Times a Forecaster Had a Smaller Error		
	CBO	Administration	Ties
Growth in Gross National Product	7	2	2
Inflation as Measured by the Consumer Price Index	5	5	1
Nominal Short-Term Interest Rates	7	4	0
Inflation-Adjusted Short-Term Rates	9	2	0

SOURCE: Congressional Budget Office.

TABLE B-6. COMPARISON OF CBO AND ADMINISTRATION LONGER-TERM PROJECTIONS OF REAL GNP GROWTH (By calendar year)

		CBO		Administration	
	Actual	Forecast	Error	Forecast	Error
1978-1981	2.4	4.6	2.2	4.8	2.4
1979-1982	0.4	3.5	3.1	3.7	3.3
1980-1983	0.7	2.0	1.3	2.6	1.9
1981-1984	2.4	2.6	0.2	3.7	1.3
1982-1985	2.7	2.8	0.1	3.8	1.1
1983-1986	4.1	3.6	-0.5	3.3	-0.8
1984-1987	4.1	4.1	0.0	4.3	0.2
1985-1988	3.5	3.3	-0.2	4.0	0.5
1986-1989	3.4	3.3	-0.1	3.8	0.4
Mean Error	n.a.	n.a.	0.7	n.a.	1.1
Mean Absolute Error	n.a.	n.a.	0.9	n.a.	1.3
Root Mean Square Error	n.a.	n.a.	1.4	n.a.	1.6

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Commerce, Bureau of Economic Analysis.

NOTES: Actual values are the four-year growth rates for gross national product (GNP) currently reported by the Bureau of Economic Analysis, not the first reported values. Forecast values are for the real average annual growth in GNP over the four-year period. The forecasts were issued in January of the initial year of the period. Errors are forecast values minus actuals; thus, a positive error is an overestimate.

n.a. = not applicable.

1980 and 1982. In subsequent years, the upward bias was much smaller for the Administration's projections, and there was virtually no bias in CBO's projections.

The size of the root mean square errors for the entire period for both CBO and the Administration is also largely the result of errors in the first three years. Moreover, CBO had a definite edge in the projections made in January 1981 and 1982, and a lesser edge in later years. CBO's projection of four-year real GNP growth was more accurate than the Administration's for every one of the nine periods compared here.

THE USE OF STATISTICS ON FORECAST ACCURACY

For a number of reasons, the statistics on errors reported here may not be useful for estimating the accuracy of future forecasts. The first is that the sample here of 11 forecasts for the two-year horizon is relatively small, and the difference between the accuracy of CBO's forecasts and those of the Administration is not statistically significant given the small sample. Second, the procedures and purposes of each organization's forecasts have changed over the period and may change in the future. For example, in the late 1970s, CBO characterized its long-term projection as a goal for the economy, whereas now CBO considers it a projection that will prevail on average if the economy continues to reflect historical trends. Third, an institution's ability to forecast may change over time. Lastly, forecast errors are closely related to how erratically the economy performs. This relationship can be clearly seen in the tables by comparing the errors in the 1980-1983 period with those of subsequent years. If the economy were again to experience a severe recession, both CBO's and the Administration's forecast errors would almost certainly be larger than the averages of the 11 forecasts examined here.

APPENDIX C

MAJOR CONTRIBUTORS TO THE REVENUE AND SPENDING ESTIMATES

The following analysts prepared the revenue and spending estimates in this report:

Revenue Estimates

Mark Booth	Corporate income taxes, Federal Reserve System earnings
Leonard Burman	Individual income taxes
Maureen Griffin	Social insurance contributions, excise taxes, estate and gift taxes
Jon Hakken	Corporate income taxes
Richard Kasten	Individual income taxes
Eric Nicholson	Excise taxes
Rosemarie Nielsen	Individual income taxes
Larry Ozanne	Individual income taxes
Linda Radey	Individual income taxes, excise taxes
Caroline Ratcliffe	Customs duties, miscellaneous receipts
Frank Sammartino	Individual income taxes

Spending Estimates

Defense and International Affairs

Eugene Bryton	Defense
Kent Christensen	International affairs
Raymond Hall	Defense
Barbara Hollinshead	Defense
William Myers	Defense
Amy Plapp	Defense
Lisa Siegel	Defense
Joseph Whitehill	International affairs
Ben Wolters	Defense

Spending Estimates (continued)

Human Resources

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Cathy Ellman	Civil Service Retirement, Supplemental Security Income
Alan Fairbank	Hospital Insurance
Karen Graham	Public Health Service
Alice Grant	Social service programs, Head Start
Holly Harvey	Supplementary Medical Insurance
Jean Hearne	Medicaid
Lori Housman	Medicare
Julia Isaacs	Food Stamps, child nutrition
Deborah Kalcevic	Education
Cory Leach	Unemployment Insurance, training programs, veterans' education
Donald Muse	Medicaid, Medicare
Janice Peskin	Aid to Families with Dependent Children, child support enforcement
Kathleen Shepherd	Veterans' benefits

Natural and Physical Resources

Laura Carter	Pollution control and abatement, deposit insurance
Kim Cawley	Energy
Douglas Criscitello	Commerce, disaster relief and insurance
Peter Fontaine	Energy
Theresa Gullo	Water resources, conservation, and land management
James Hearn	General government, Agricultural Credit Insurance Fund, Outer Continental Shelf receipts
David Hull	Agriculture
Mary Maginniss	Deposit insurance
Eileen Manfredi	Agriculture

Spending Estimates (continued)

Natural and Physical Resources (continued)

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Marta Morgan	Community and regional development, general government
Andrew Morton	Agriculture
Deborah Reis	Recreation, water transportation
Mitchell Rosenfeld	Air transportation, justice, Postal Service
Brent Shipp	Housing and mortgage credit
Michael Sieverts	Science and space, justice, other natural resources

Other

Janet Airis	Appropriation bills
Edward Blau	Appropriation bills
Paul Christy	Other interest
David Elkes	National Income and Product Accounts
Betty Embrey	Appropriation bills
Kenneth Farris	Computer support
Danila Girerd	Credit budget
Glen Goodnow	Authorization bills
Vernon Hammett	Computer support
Sandra Hoffman	Computer support
Richard Krop	Civilian agency pay
Fritz Maier	Computer support
Rodney Rasmussen	Net interest on the public debt
Kathy Ruffing	Treasury borrowing, interest, and debt
Robert Sempsey	Appropriation bills
Karla Sweeney	Appropriation bills
Jeff Swersey	Computer support
Rick Williams	Computer support